CALIFORNIA SENATE REPUBLICANS

Highlights and Analysis of the 2025-26 Governor's Budget

January 23, 2025

SENATE REPUBLICAN FISCAL OFFICE

Table of Contents

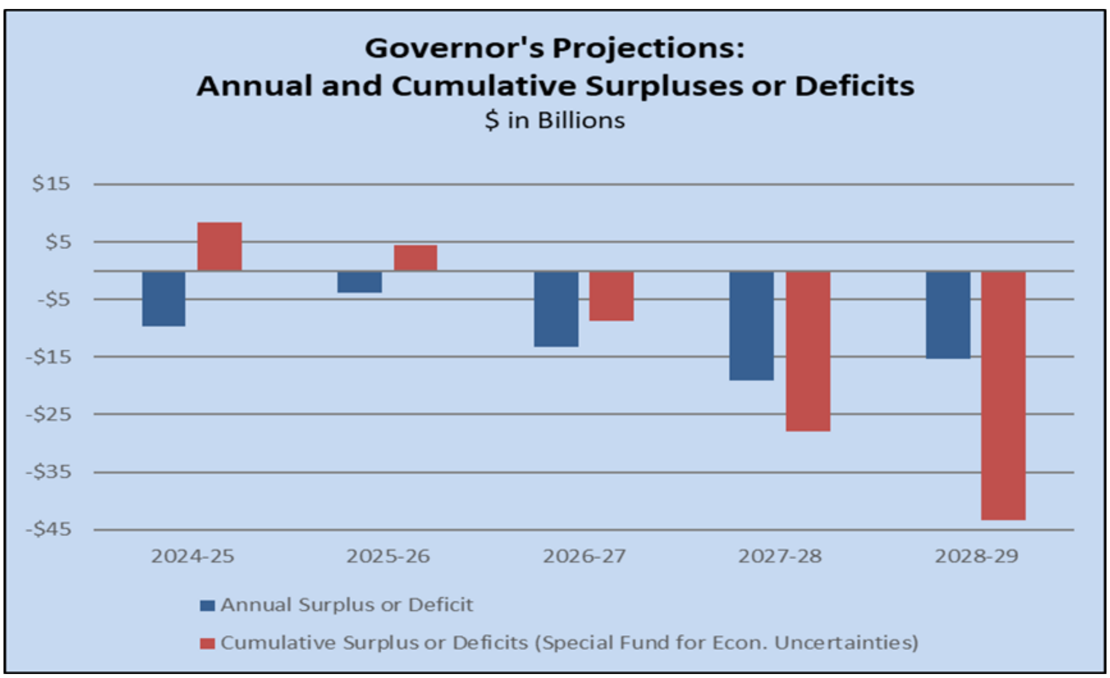
Executive Summary

Governor Claims Small Surplus; Nonpartisan Analyst Projects Deficit. The Governor's budget projects a small "surplus" of $363 million for 2025-26, resulting in part from an increase in revenue projections and the withdrawal of $7.1 billion from state reserves. However, the nonpartisan Legislative Analyst's Office (LAO) estimated that the state would have a deficit of $2 billion. The difference in the Governor's and LAO's projections appears to be the net result of the Governor's higher revenue projections, offset partially by higher expenditures, though details remain to be sorted out.

Although this difference is small as a percent of state spending, it is a crucial distinction because recognizing a $2 billion deficit would require proposing the same amount of solutions, which could affect numerous state programs. Since the Governor does not forecast a deficit, the budget does not include any proposed solutions. Also, many Californians would find it strange to claim there is a budget surplus when the state has to withdraw funds from its reserves to pay its bills.

Claims of a Balanced Budget Undercut by Previous Deficit Actions. Many Californians would find it strange to claim the budget is balanced when the state has to withdraw funds from reserves to pay its bills. The state took actions during the 2024 budget process to address the deficit projected at that time for 2025-26. These actions included $27 billion in budget solutions for 2025-26, including the withdrawal of $7.1 billion from reserves as well as fund shifts, tax increases, and reductions.

Massive Deficits Persist Throughout Forecast. The Governor's multiyear forecast also indicates the state will have annual operating deficits ranging from $13 billion to $19 billion each year through 2028-29, as illustrated in the chart below. If left unaddressed, these deficits would generate a cumulative deficit of $43 billion by 2028-29. In spite of this dismal projection, the Governor proposes no budget solutions to establish a structurally balanced budget.



Revenues Above Levels Previously Projected. The Governor's budget reflects General Fund revenues of $218 billion in the current 2024-25 fiscal year, higher than the enacted budget level by $10 billion. This total would remain flat at $218 billion in 2025-26 under the Governor's plan. When considering the three-year budget “window,” the Governor’s budget estimates that General Fund revenues will be higher by nearly $17 billion combined through the 2025-26 budget year, compared to levels assumed in last summer’s enacted budget.

Expenditure Growth Driven by Health and Human Services (HHS) Expansions. When comparing the proposed General Fund spending for 2025-26 to the enacted 2024-25 budget, an astonishing increase of more than $17 billion can be seen. The table below summarizes the changes by major program area. Most notably, spending for HHS programs grows by nearly $12 billion from the enacted level. This increase is the result of higher-than-expected costs for Medi-Cal benefits for undocumented immigrants, as well as growth in the In-Home Supportive Services program and Child Care programs. In short, the Governor and legislative Democrats have continued to ramp up major expansions in new or expanded entitlement programs, even while slashing university budgets, underfunding fire prevention, borrowing, and withdrawing over half the state’s budget reserves.

General Fund Expenditures by Agency
(Dollars in Millions)

Agency	2024-25 Enacted June 2024	2024-25 Revised Jan. 2025	2025-26 Proposed Jan. 2025	2025-26 Change from Enacted 2024-25
Legislative and Executive	$4,367	$7,427	$4,438	$71
Courts	$3,222	$3,182	$3,356	$134
Business, Consumer Services, Housing	$1,324	$3,754	$285	-$1,038
Transportation	$209	$237	$160	-$49
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Corrections and Rehabilitation	$13,749	$13,635	$13,203	-$546
TK-14 Education (Proposition 98)	$82,612	$85,053	$84,603	$1,990
Higher Education (Non-Prop. 98)	$20,170	$20,252	$19,574	-$596
Labor and Workforce Development	$949	$1,121	$963	$14
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General Government	$821	$4,377	$5,339	$4,518
Capital Outlay	$567	$850	$485	-$82
Debt Service	$5,856	$5,635	$6,183	$327
Total, General Fund Expenditures	**$211,504**	**$232,051**	**$228,892**	**$17,388**

Reserves Severely Diminished After Recent Withdrawals. The proposed budget would withdraw $7.1 billion from the state’s reserves in 2025-26, as planned during last year’s budget process. This would leave $17 billion in remaining reserves, which is a relatively low 6.8 percent of General Fund resources in 2025-26.

Federal Funds Uncertain for Health Mandate, Other Programs. The Governor’s budget is counting on the federal government to provide $6 billion to pay for the state’s recently enacted health facility wage mandate (SB 525, Durazo). The budget expands the Hospital Quality Assurance Fee to generate $6 billion in federal funds to help pay the costs, but the scheme requires approval from the Trump administration. The state projects total federal funds of $171 billion in 2025-26, primarily through Medi-Cal, and some of those funds could be at risk from federal cutbacks as well.

Housing and Homelessness

Budget Fails to Provide New Funding for Housing Programs. The January budget does not include any new funding for the state's various housing programs. Rather, the Governor proposes yet another bureaucratic expansion with the creation of a new agency, the California Housing and Homelessness Agency. The proposal would move through the existing process overseen by the Little Hoover Commission, and few details are available at this time.

No Details, but Housing Policy Principles Outlined. Although the Governor does not include any new General Fund for housing programs, the budget does outline what is identified as "policy principles" for housing. These principles include ways to reduce the cost to build, improve accountability, and advance policies that promote climate change initiatives, such as transit-oriented housing development. It remains to be seen if the Governor will release specific trailer bill language to effectuate these principles or if the budget rhetoric is just intended to mitigate the obvious concerns for the lack of progress in addressing California's housing woes.

Budget Fails to Provide New Flexible Funding for Local Governments' Homelessness Programs. The Governor's budget fails to include any new General Fund in 2025-26 for the Homeless Housing Assistance and Prevention program, a program local governments rely on to provide flexible funding necessary to support various local homelessness efforts.

Encampment Resolution Grant Program. The budget includes $100 million General Fund for the Encampment Resolution Grant Program. The program provides grant funding to assist local governments with resolving critical encampment concerns and transitioning individuals into safe and stable housing.

TK-12 Education

Proposition 98 Education. The Governor's budget includes $137 billion ($83 billion General Fund and $54 billion other funds) for all TK-12 education programs. Proposition 98 funding for TK-12 schools and community colleges in 2025-26 is $119 billion. The budget maintains a Proposition 98 funding level of $99 billion in 2023-24. The revised 2024-25 Proposition 98 guarantee is calculated at $119.2 billion, however, the budget proposes to fund the guarantee at $117.6 billion, for a difference of $1.6 billion. According to the Department of Finance, this is to provide a buffer for changes in the guarantee before the final calculations are made.

Proposition 98 General Fund spending per pupil would be $18,918 in 2025-26 and $24,764 per pupil from all funding sources. This is a Proposition 98 General Fund increase of $7,041 per pupil, or 59 percent, compared to six years ago in 2019-20, the year before the pandemic started. When accounting for all funds, it is an increase of $7,750 per pupil, or 46 percent.

Local Control Funding Formula. The Governor's budget proposes a $2.5 billion increase in the Local Control Funding Formula (LCFF). This reflects a 2.43 percent cost of living adjustment (COLA) and population growth adjustments.

Proposition 98 Reserve. The budget reflects a revised final balance in the Public School System Stabilization Account of $1.5 billion at the end of 2025-26. This reflects revised deposits of $1.2 billion and $376 million in 2024-25 and 2025-26 respectively, both of which are mandatory. The balance in 2024-25 is $1.2 billion, which does not trigger the previously authorized (but ill-advised) 10 percent cap on local school district reserves in 2025-26.

Student Support and Professional Development Discretionary Block Grant. The Governor's budget proposes $1.8 billion one-time Proposition 98 General Fund for the Student Support and Professional Development Discretionary Block Grant. According to available information, the funding is intended for career pathways and dual enrollment expansion, teacher recruitment and retention, and professional development for teachers on mathematics, English language arts, and literacy.

Proposition 2 School Facility Funding. The Governor's budget notes that the passage of Proposition 2 in November 2024 authorized $8.5 billion in state General Obligation bonds for K-12 schools, which will be allocated through the existing School Facility Program. The bond funding allocation is $4 billion for modernization projects, $3.3 billion for new construction, $600 million for charter schools, and $600 million for career technical education projects. It should be noted that the 2024-25 budget eliminated a planned $550 million one-time General Fund investment in the Preschool, Transitional Kindergarten, and Full Day Kindergarten Facility Grant program, and another planned $875 million one-time General Fund investment in the School Facility Program, in anticipation of the bond passing.

Literacy Screenings and Instruction. The Governor's budget proposes $500 million one-time Proposition 98 General Fund for TK-12 Literacy and Mathematics Coaches, which builds upon $500 million one-time Proposition 98 General Fund provided in prior budgets. In addition, the Governor's budget proposes $40 million one-time Proposition 98 General Fund to support training educators on literacy screenings and other costs, such as screening materials. The 2024 Budget Act also appropriated $25 million one-time Proposition 98 General Fund for professional development related to the implementation of literacy screenings for reading disabilities in kindergarten through second grade.

Higher Education

University Deferrals and Reductions Maintained. The Governor's budget maintains previously planned deferrals and reductions to the University of California and California State University systems. The University of California's five percent base increase of $241 million and $31 million for the replacement of 902 nonresident undergraduate students is deferred to 2027-28. The California State University five percent base increase of $252 million is deferred to 2027-28. Under last year's budget actions, both the University of California and California State University are subject to a 7.95 percent General Fund operations reduction, representing $397 million and $375 million, respectively.

Community Colleges Categorical Cost of Living Adjustment. The Governor's budget includes $230 million ongoing Proposition 98 General Fund to provide a 2.4 percent cost-of-living adjustment for Student-Centered Funding Formula apportionments and $30 million ongoing Proposition 98 General Fund for 0.5 percent enrollment growth.

Community College Facilities Bond Funding. Following the voters' enactment of the Proposition 2 education bond, the budget proposes $52 million one-time bond funds allocated for infrastructure, modernization, and enrollment growth projects for 28 community college facilities.

Credit for Prior Learning Expansion. The Governor's budget includes $100 million one-time Proposition 98 General Fund ($7 million of which is ongoing) to update and modify credit for prior learning policies. Students' past experiences, such as military service, could earn course credit. This proposal is part of the Governor's Master Plan for Career Education.

Health

Higher Caseload, Pharmacy Costs, and Giveaways Increase Medi-Cal Budget. The Governor's budget estimates that current Medi-Cal enrollment has increased to 15 million Californians at a cost of $38 billion General Fund in 2024-25, an increase of more than 450,000 individuals and $2.8 billion General Fund over the 2024 Budget Act estimates. The Governor also projects a $1.5 billion General Fund increase in pharmacy expenditures through 2025-26. For the 2025-26 budget year, the Governor proposes a record $42 billion General Fund for Medi-Cal expenditures, a $4.5 billion year-over-year increase from 2024-25, an amount that includes the ongoing costs of prior-year Democrat priorities such as the expansion of Medi-Cal to 1.5 million undocumented individuals and the increase in wage mandates for healthcare facilities, which took effect in October 2024.

Concerning Delay of Proposition 35 Implementation. Proposition 35, approved by the voters in November 2024 and supported by a large coalition of Medi-Cal providers, permanently authorizes the state to impose a tax on managed care plans (MCO tax), and restricts use of the MCO tax proceeds to Medi-Cal provider reimbursement rate increases. The Governor's budget assumes that full implementation of Proposition 35 would be delayed until 2026 after the administration negotiates a new spending plan with the provider coalition. In doing so, the Governor sweeps an additional $1 billion of MCO tax for General Fund relief. Medi-Cal providers may question the Governor's interpretation of the proposition requirements and could challenge the proposal to take more MCO tax for budget relief.

Free Diapers for Newborns. The Governor proposes the creation of a new state program to supply three-month's worth of diapers for every family with a newborn baby. The Governor proposes using $7.4 million in General Fund in 2025-26 and $13 million in future years to cover this new benefit, which would be implemented through state contracts with hospitals. Legislators may question whether this program should be open to all Californians or should be limited to those families truly in economic need. It is also unclear how this proposal would overlap with existing health and human services entitlements.

Developmental Services

Finally Implementing Rate Increases to Developmentally Disabled Service Providers. The Governor finally funds a long-delayed promise to families with developmentally disabled individuals by including an additional $2.3 billion General Fund through 2025-26 to increase the reimbursement rates for service providers. These rate increases will allow service provider vendors to hire more individuals in order to serve the growing demand for services. The Governor also plans to release a Master Plan for Developmental Services in March 2025 to outline future improvements in the delivery of services.

Human Services

Department of Social Services Total Budget. The Governor's proposed budget for the Department of Social Services is $62 billion ($23 billion General Fund) for 2025-26.

CalWORKs Federal Pilot Program. California was selected as one of five states to participate in a federal pilot program that seeks to test alternative benchmarks to work participation rates. This means California's entire CalWORKs program will be operating under alternative accountability measures.

While details are still being worked out on how the state will advance the goals of the pilot project, prior authorizations were provided to the Department of Social Services to consider proposals to modify the existing welfare-to-work process, limit sanctions, and repeal the federal work participation rate penalty pass-through.

CalWORKs Grant Increase. The Governor's budget includes a 0.2 percent increase to the CalWORKs Maximum Aid Payment levels, estimated to cost $9 million in 2025-26. This increase is funded entirely by the Child Poverty and Family Supplemental Support Subaccount, a fund source that the state previously realigned to counties. While this expansion is being covered by the subaccount, it should be noted that if the subaccount ever has insufficient funding to cover this increase or any prior grant increases, General Fund will be used to backfill the difference.

Child Care and Early Education

Child Care Collective Bargaining and Rate Increases. The Governor's budget includes $6.4 billion ($4.6 billion General Fund) for child care and development programs in 2025-26. No new child care proposals have been included in the Governor's budget, but are expected to appear at a later time. The current bargaining agreement with Child Care Providers United (CCPU) expires on June 30, 2025. The Administration is still in negotiations with CCPU for a new agreement, which is likely further complicated by the continued push to roll out an alternative rate methodology. The 2024 budget set a requirement that the Governor and Legislature establish reimbursement rates based on the alternative methodology by no later than July 1, 2025. No details have been provided on the potential cost of the new bargaining agreement with CCPU.

Public Safety

Worsening Crime Trends Continue With no Plan to Combat Them. Violent crime continues to increase in California. Property crime rates are worse in this state than the rest of the nation in all four categories tracked by the Federal Bureau of Investigation. Californians are 51 percent more likely to be victims of violent crime and 31 percent more likely to be victims of propery crime than other Americans on average. Despite these alarming statistics, the Governor's budget fails to reflect any comprehensive plan to address crime. In fact, the only truly new funding to combat crime is $5 million for the California Highway Patrol to increase investigations into human trafficking and distribution of child pornography (see below).

Child Pornography and Human Trafficking Investigations. The budget proposes $5 million General Fund and 12 positions ongoing, beginning in 2025-26, for the California Highway Patrol to assist local law enforcement agencies with multi-jurisdictional investigations into human trafficking and the distribution of child sexual abuse material. These resources will help to combat the recent alarming increase in child pornography that has been closely linked with human trafficking.

Bare Minimum for Proposition 36 Implementation. The Governor's budget funds the projected increase in the state prison population of 818 inmates in 2024-25 and 1,606 in 2025-26, but fails to include any funding for the courts to hear more felony cases, nor does it provide any funding for cities or counties to provide court-ordered treatment and services to offenders that are at the heart of Proposition 36. This budget essentially ignores the will of the voters, nearly 70 percent of whom supported Proposition 36 despite the Governor's opposition to the measure.

Continuing to Soften the Prison Experience. The budget proposes $7.8 million in 2025-26 and $13 million annually thereafter to increase staffing and expand rehabilitative programming at the San

Quentin Rehabilitation Center. This new funding will further the San Quentin implementation of the "California Model", which focuses on trauma-informed programming, normalization of the physical environment, and generally making prison feel less like prison. It seems unlikely these measures will enhance public safety in any measurable way over the long term.

Partial Reversal of Ill-Advised Trial Court Reduction. The Governor's proposed budget reverses $42 million of a $97 million unallocated reduction to trial court operations that was included in the 2024 Budget Act. This unallocated reduction would have required courts to re-calendar cases to meet statutory timelines for criminal caseloads, which ultimately would have led to worsening backlogs of civil cases. While the $42 million reversal is an improvement, the trial courts still face a $55 million reduction in 2024-25 and ongoing, which unfortunately means civil case delays and backlogs are still likely.

Fire Issues

Fire Prevention Still Short of Need. An examination of recent trends in wildfire prevention and response shows that, although CalFIRE's budget increased substantially during the recent surplus years, funding for prevention is still far short of the need. CalFIRE is not close to meeting its annual commitment of treating 500,000 acres of forest per year, instead treating less than one-third of that goal in recent years.

Bond Funds for Fire. The budget proposes $325 million from the climate bond for fire-related issues, including $82 million for forest health, $80 million for regional efforts, $59 million for local fire grants, and smaller amounts for state lands and wildfire mitigation. Without a clear focus on long-term forest management or ensuring grants are used effectively, however, these measures may fall short of reducing fire risks or addressing California's escalating wildfire crisis.

Climate Bond Spending

Overall Climate Spending Relies on Bond Funds. The Governor's budget heavily relies on allocating $2.7 billion in funds from the recently passed climate bond (Proposition 4) to manage the state's resources and address an array of environmental and infrastructure challenges. Specific allocations include the following:

- ***Water Projects.*** $232 million is earmarked for dam safety, $183 million for water quality, $173 million for flood management, $153 million for water reuse, $148 million for Salton Sea restoration, and $174 million for water storage. However, the budget overlooks opportunities to link water quality with flood management, potentially leaving communities vulnerable to disasters and higher future costs.
- ***Coastal Resilience.*** Proposed spending includes $31 million for resilience projects, $20 million for sea level rise mitigation, and $8.5 million for dam removal.
- ***Extreme Heat Mitigation.*** With $47 million for urban greening, $38 million for fairground updates, and $16 million for community programs.
- ***Biodiversity.*** $176 million supports fish and wildlife conservation, $80 million goes to state conservancies, and $9.4 million is allocated for tribal nature-based projects. Tribal initiatives, however, receive disproportionately low funding, and the lack of coordination with wildfire prevention efforts could reduce overall effectiveness.
- ***Climate-Smart Agriculture.*** Allocations include $38 million for water efficiency, $36 million for healthy soils, and $20 million for invasive species.

- ***Outdoor Access.*** Parks receive $190 million for statewide programs, $84 million for deferred maintenance, and $11 million for recreation.
- ***Offsetting General Fund Expenditures with Bond Funds.*** The plan shifts $273 million from General Fund obligations to climate bond funding for land stewardship, recycling, and dam safety. This lacks transparency, as the selection criteria for these projects remain unclear, raising concerns about fiscal accountability.
- ***Port Upgrades for Offshore Wind Development.*** The Governor proposes $228 million for upgrades to California ports to accommodate the development of offshore wind electricity generation. Spending taxpayer dollars on port upgrades prior to fully assessing the environmental impacts and viability of floating windmills may be placing the cart before the horse.
- ***Transportation Fuel.*** The budget allocates $2.3 million to explore higher ethanol blends (E15). While a step forward, the plan overlooks the potential costs and benefits of transitioning, risking ineffective policies without adequate scientific backing or stakeholder input.

Tax Policy

Expands the Hollywood Film Tax Credit. The Governor's January budget prioritizes the Film and Television Tax credit program, increasing the available tax credits from $330 million to $750 million annually from 2025-26 through 2029-30. The budget assumes a revenue reduction of $15 million in 2025-26, growing to more than $200 million annually.

Single Sales Factor Would Increase Taxes on Corporations. The Governor's budget would increase General Fund revenues by $330 million in 2025-26 as a result of requiring multi-state financial firms to use a mandatory single sales factor policy instead of the equally weighted three-factor formula. With this change, a California-based financial corporation with significant payroll and property in the state could be able to reduce its tax bill with the proposed switch to a single sales factor, but an out-of-state financial corporation that has relatively high sales in California compared to its property and payroll would see the tax liability of the company increase.

Retirement Income Exclusion for Vets. The budget includes a reduction of $130 million in General Fund revenue (projected loss of $85 million General Fund annually thereafter) as a result of excluding from taxable income military retirement and survivor benefit payments received by a veteran from the federal government. The proposal would exclude up to $20,000 and would be limited to taxpayers with up to $250,000 in income for joint filers, and $125,000 in income for single filers.

Wildfire Settlements Income Exclusion. The budget proposes to exempt all wildfire settlements from state taxation for settlements paid in tax years 2025 through 2029, regardless of when the fire occurred. Republicans have proposed similar exemptions in the past that were not enacted, so this proposal is a welcome step, though relief for prior fires is still lacking.

Extension of Pass-Through Entity Elective Tax. The budget proposes to extend the state's pass-through elective tax if the federal government extends the state and local tax payment changes enacted in the Tax Cut and Jobs Act of 2017. These tax policies are set to expire after 2025.

Labor and Employment

CalCompetes Grant Program Prioritized. The budget proposes $60 million in one-time General Fund for the CalCompetes Grant program, which was created in 2021-22 and is meant to provide financial assistance to businesses unable to participate in the CalCompetes Tax Credit program.

New Funding for Social Enterprises. The budget includes $17 million in one-time General Fund for the Regional Initiative for Social Enterprises Program, a grant program intended to provide specialized support to people facing high barriers to work, connecting employment social businesses with the other job training programs.

Interest Payment for Unemployment Debt. The Governor's budget includes $634 million (General Fund) for the annual interest payment on the state's growing $21 billion Unemployment Insurance loan from the federal government. Previously, the Governor planned to use $50 million from the Employment Training Fund (paid by employers) to cover a portion of the 2025-26 payment. However, after the current year $100 million interest payment from this fund, it was determined further interest payments would require reductions to employment training programs meant to create a skilled and productive workforce. These interest payments and the increased tax burden on California businesses would have been avoided if the Governor had used past surplus funds to pay off the federal loan.

Employment Development Department Problems. The proposed budget includes $124 million ($62 million General Fund) for the Employment Development Department's computer systems, improved service for claimants, and fraud prevention. This money would fund the fourth year of a five-year modernization plan which began in 2022-23.

Erosion of State Operations Savings and Vacancy Sweep. In order to help address last year's $71 billion deficit, the 2024-25 budget authorized statewide operations savings of up to 7.95 percent and the elimination of 10,000 vacant state positions. The Governor's budget now reflects lower-than-projected results from these two actions. Savings for the 7.95 operations reductions are now projected to be $1.2 billion in 2025-26 and thereafter, compared to last year's assumed savings of $2.7 billion. The number of vacancies swept would be 6,500, rather than 10,000, and the resulting savings would be $234 million General Fund, rather than the previously assumed $763 million. During last year's budget process, the nonpartisan LAO and Senate Republicans raised concerns that the promised savings would in fact not appear as promised, and the Governor's proposal now validates these concerns.

Transportation

Gas Taxes Increase Again. Despite claims to prioritize affordability for Californians, the Governor proposes no changes to existing law, continuing the automatic annual tax increases to gasoline and diesel fuel. Gasoline taxes are estimated to increase as of July 1, 2025, by 1.1 cents per gallon (cpg), to 60.7 cpg, and diesel fuel taxes would increase by 0.8 cpg, to 46.2 cpg.

High-Speed Rail. Proposes $980 million in 2025-25 for continued construction and reflects increased current year spending of $2.3 billion, mostly from carryover Cap and Trade funds from the prior year.

General Government

Expands the Governor's College Corp Volunteer Program. The budget provides $68 million in 2025-26 and $84 million ongoing thereafter to permanently establish the College Corp Program within the Governor's Office of Service and Community Engagement.

Capital Funding for Non-Profit Technology Center. The budget provides $25 million to reimburse Natcast, a non-profit entity designated to operate the National Semiconductor Technology Center. The new facility is expected to bring in hundreds of millions of dollars in new research funding and create more than 200 new jobs over the next ten years.

Another New "Feel Good" Program. The budget would provide $5 million General Fund to launch what would be known as a "Belonging Campaign" within the Administration. This new program would include research projects to evaluate how Californians define belonging and how connected they feel to their communities.

Overall Budget Condition

Key Points

- **Governor Claims Small Surplus; Nonpartisan Analyst Projects Deficit.** Governor claims a balanced budget while nonpartisan analyst estimates a $2 billion deficit.
- **Claims of a Balanced Budget Undercut by Previous Deficit Actions.** Budget is supported by $27 billion in deficit solutions enacted last year, including a $7.1 billion reserve withdrawal.
- **Expenditure Growth Driven by Health and Human Services (HHS) Expansions.** Spending is up by $17 billion compared to enacted 2024-25 budget, driven by higher costs stemming from major recent HHS expansions.
- **Deficits Persist Throughout Forecast.** Lack of ongoing budget-balancing actions mean that deficits of $13 billion to $19 billion persist throughout the forecast.
- **Reserves Severely Diminished After Withdrawals.** Two years of reserve withdrawals leave California ill-prepared for future deficits.
- **Federal Funding Uncertain for Health Wage Mandate and Other Programs.** Budget counts on $6 billion in federal funds to pay for recent state health facility wage mandate, but Trump administration must approve the request.

Governor Claims Small Surplus; Nonpartisan Analyst Projects Deficit. The Governor's budget projects a small "surplus" of $363 million for 2025-26, resulting in part from an increase in revenue projections and the withdrawal of $7.1 billion from state reserves. However, the nonpartisan Legislative Analyst's Office (LAO) estimated that the state would have a deficit of $2 billion. The difference in the Governor's and LAO's projections appears to be the net result of the Governor's higher revenue projections, offset partially by higher expenditures, though details remain to be sorted out.

A deficit of $2 billion is small as a percent of the $229 billion General Fund budget, leading the LAO to describe the budget as "roughly balanced" despite the shortfall. However, recognizing the likelihood of a deficit is a crucial distinction because it would require proposing the same amount of solutions. Finding $2 billion in solutions could affect numerous state programs. Since the Governor does not forecast a deficit, the budget does not include any proposed solutions.

Claims of a Balanced Budget Undercut by Previous Deficit Actions. Many Californians would find it strange to claim the budget is balanced, or even has a small surplus, when the state has to withdraw funds from reserves to pay its bills. The state took actions during the 2024 budget process to address the deficit projected at that time for 2025-26. These actions included $27 billion in budget solutions for 2025-26, including the withdrawal of $7.1 billion from reserves as well as fund shifts, tax increases, and reductions. The approach of addressing two years of deficits last year is to be commended, but taking the actions early does not equate to claiming the budget is inherently balanced now.

Revenues Above Levels Previously Projected. The Governor's budget reflects General Fund revenues of $218 billion in the current 2024-25 fiscal year, higher than the enacted budget level by $10 billion. This total would remain flat at $218 billion in 2025-26 under the Governor's plan. When considering the three-year budget "window," the Governor's budget estimates that General Fund revenues will be higher by nearly $17 billion combined through the 2025-26 budget year, compared to levels assumed in last summer's enacted budget.

Expenditure Growth Driven by Health and Human Services (HHS) Expansions. General Fund expenditures under the Governor's proposal would reach a revised total of $232 billion in the current fiscal year, which is, surprisingly, $20 billion above the level enacted seven months ago for the 2024-25 budget. Preliminarily, this increase appears to be partially the result of expenditures shifting from 2023-24 into 2024-25, but also higher revised estimates for HHS programs, including an increase of $2.8 billion in Medi-Cal expenditures following recent eligibility expansions.

When comparing the proposed General Fund spending for 2025-26 to the enacted 2024-25 budget, an astonishing increase of more than $17 billion can be seen. The table below summarizes the changes by major program area. Most notably, spending for HHS programs grows by nearly $12 billion from the enacted level. This increase is the result of higher-than-expected costs for the recent expansion of full Medi-Cal benefits for undocumented immigrants, as discussed further in the *Health* section. This expansion also creates significantly higher costs in the In-Home Supportive Services program, as discussed in the *Human Services* section. Child care spending has also skyrocketed due to recent expansions, and is now growing by an unsustainable 20 percent per year. In short, the Governor and legislative Democrats have continued to ramp up major expansions in new or expanded entitlement programs, even while slashing university budgets, underfunding fire prevention, borrowing, and withdrawing over half the state's budget reserves.

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(Dollars in Millions)

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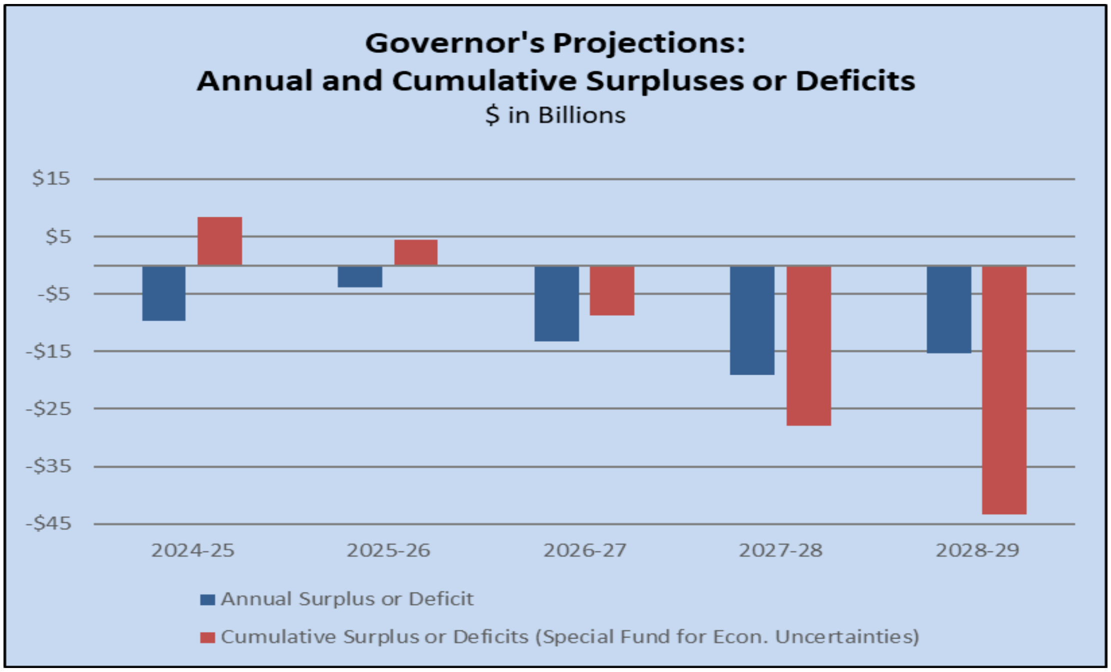
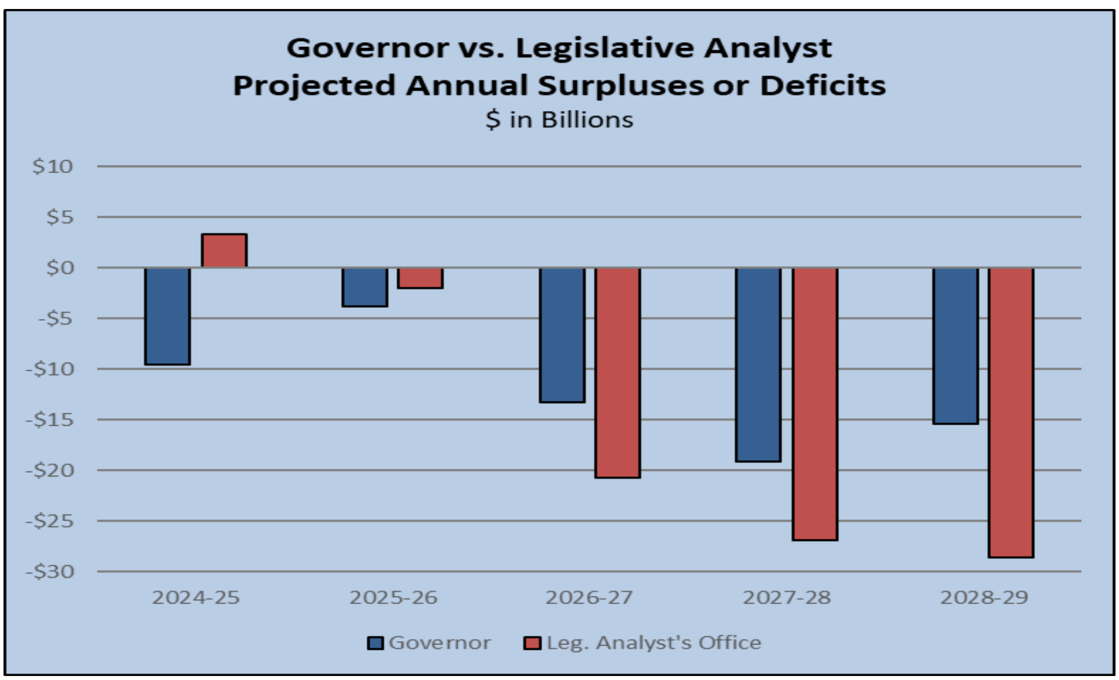
Debt Service	$5,856	$5,635	$6,183	$327
Total, General Fund Expenditures	**$211,504**	**$232,051**	**$228,892**	**$17,388**

Major Deficits Persist Throughout Forecast. The Governor's multiyear forecast also indicates the state will have annual operating deficits ranging from $13 billion to $19 billion each year through 2028-29, as illustrated in the chart on the next page. If left unaddressed, these deficits would generate a cumulative deficit of $43 billion by 2028-29. In spite of this dismal projection, the Governor proposes no budget solutions to establish a structurally balanced budget.



As noted above, the nonpartisan LAO projects lower revenues than does the Governor. The LAO's forecast also indicates annual operating deficits will be higher than the Governor estimates. The chart below compares these annual deficit forecasts.



Reserves Severely Diminished After Recent Withdrawals. The proposed budget would withdraw $7.1 billion from the state's reserves in 2025-26, as planned during last year's budget process. This would leave $17 billion in remaining reserves, which is a relatively low 6.8 percent of General Fund resources in 2025-26. The proposed changes and remaining reserve balances include the following:

- Withdrawal of $7.1 billion from the state's Rainy Day Fund in 2025-26, in addition to the current year withdrawal of $4.9 billion. These withdrawals would leave $11 billion remaining in the Rainy Day Fund.
- A deposit of $376 million into the Proposition 98 Rainy Day Fund, leaving a balance of $1.5 billion in that account, which can only be used for education funding.
- A $4.5 billion balance in the discretionary reserve (the Special Fund for Economic Uncertainty).

Total State Funds Increase from Prior Enacted Budget. When counting all state funds, the 2025-26 budget would reach $322 billion, a decline of about $10 billion from the current year, as shown in the table below. However, when compared to the enacted 2024-25 budget, total state funds increase by 8.2 percent. Federal funds would add another $171 billion to the budget in 2025-26, an increase of nearly 12 percent from the enacted current year. Adding all these funds, the amount of total spending through the state would increase by 9.3 percent from the enacted 2024-25 budget level.

Expenditures by Fund Category
Dollars in Billions

	2024-25 Enacted		2024-25 Revised		2025-26 Proposed	
	$	% of Total	$	% of Total	$	% of Total
General Fund	$212	47%	$232	46%	$229	46%
Special Funds	$84	19%	$96	19%	$87	18%
Bond Funds	$2	1%	$4	1%	$7	1%
Total, State Funds	**$298**	**66%**	**$332**	**66%**	**$322**	**65%**
Change from enacted			12%		8.2%	
Federal Funds	$153	34%	$168	34%	$171	35%
Total, All Funds	**$451**	**100%**	**$500**	**100%**	**$493**	**100%**
Change from enacted			11%		9.3%	

Federal Funds Uncertain for Health Mandate, Other Programs. The Governor's budget is counting on the federal government to provide $6 billion for the state's recently enacted health facility wage mandate (SB 525, Durazo). Despite the deficit last year, the Governor and legislative Democrats foolishly pushed ahead with implementation of this misguided policy in the Fall of 2024. The budget counts on an expansion of a hospital-based fee to generate $6 billion in federal funds to pay the costs, but the scheme requires approval from the Trump administration. Without this federal funding, it is unclear how the state would pay these costs, which it has already begun incurring. Republicans at the national level have discussed placing conditions on federal funds for other programs as well. California is assuming $171 billion in federal funds in its proposed budget for 2025-26, and most of those funds flow through the Medi-Cal program. Even if Congress makes cuts, most of the current federal funding to Medi-Cal is likely to continue, but the $6 billion for the wage mandate may be most at risk. California can no longer assume automatic financial support from the federal government for many of its misguided policies.

Tax Policy

Key Points

- **Budget Increases Taxes on Businesses Again.** Proposes tax changes that would increase tax revenue by $330 million even as projected General Fund revenues increase.
- **Provides Financial Relief to Retired Military Personnel.** Proposes to exclude military retirement and survivor benefit payments from consideration as state taxable income.
- **Expands the Hollywood Film Tax Credit.** Prioritizes the Film and Television Tax credit program for expansion, increasing the annual tax credits from $330 million to $750 million.
- **Extension of Pass-Through Entity Elective Tax Tied to Federal Action.** Proposes to extend the pass-through elective tax if the federal government extends certain changes enacted in the federal Tax Cut and Jobs Act of 2017.
- **Wildfire Settlements Income Exclusion**. Proposes to exempt all wildfire settlements from state taxation for settlements paid in tax years 2025 through 2029, consistent with legislation proposed by Senator Seyarto.

Single Sales Factor Would Increase Taxes on Corporations. The Governor's budget would increase General Fund revenues by $330 million in 2025-26 by requiring multi-state financial firms to use a mandatory single sales factor policy instead of the currently required three-factor formula, which is equally weighted using sales, property and payroll data. With this change, a California-based financial corporation with significant payroll and property in the state could potentially reduce its tax bill with the proposed switch to a single sales factor, but an out-of-state corporation that has relatively high sales in California compared to its property and payroll would likely have a higher tax liability.

Note that California previously switched to using single sales factor with the passage of Proposition 39 in November 2012. California voters approved the initiative measure, which removed three-factor apportionment as an option for all except extraction, agricultural and financial firms. As a result, taxpayers, other than the excluded industries, must use a single-sales factor apportionment to determine tax liability. This new proposal would now expand the policy to financial services firms, but extraction and agricultural firms would continue to be excluded from the required use of the single sales factor for tax apportionment.

Retirement Income Exclusion for Veterans. The budget includes a reduction of $130 million in General Fund tax revenue ($85 million General Fund annually thereafter) as a result of excluding from veterans' taxable income military retirement and survivor benefit payments. The proposal would exclude up to $20,000 and would be limited to taxpayers with up to $250,000 in income for joint filers and $125,000 in income for single filers. Along with Montana, Rhode Island, Utah, and Vermont, California has been one of five states that tax military retirement pay fully, offering little to no tax benefit for retirement. Republicans are encouraged by the Governor's proposal, which is consistent with recent Senate Republican efforts led by Senator Seyarto (SB 1), to provide some level of financial relief to the brave Californians serving our country.

Expands the Hollywood Film Tax Credit. The Governor's January budget prioritizes the Film and Television Tax credit program, increasing the annual tax credits from $330 million to $750 million from 2025-26 through 2029-30. The budget assumes a tax revenue loss of $15 million in 2025-26, growing to more than $200 million annually, significantly less than the authorized $750 million. This revenue loss estimate is due to the fact the production companies cannot claim the credit until the film commission gives them final certification, which occurs after the production is completed, and even once certified, most taxpayers will claim the credits over multiple years.

Additionally, the 2023 Budget Act included SB 132, a budget trailer bill, which made the tax credit refundable, meaning businesses without sufficient tax liability to offset the credit would now be able to participate in the program. Although several other states, as well as several other countries, offer 100 percent refundable tax credits, this expansion was the first business tax credit program that California made refundable. During budget deliberations, it was noted that making the tax credit refundable could result in an accelerated loss of state revenue as companies would be able to claim the credits without a tax liability. As a result of the recent change that made the tax credit refundable, the Administration's estimate of $200 million in revenue loss annually could be understated.

The nonpartisan Legislative Analyst's Office provided a brief on the 2023-24 budget proposal and opined that the film tax credit makes the motion picture industry bigger, but the program's effect on the state's overall economy is unclear. Given this uncertainty, the Legislature should require the Administration to provide further analysis of the program's economic impact as compared to the status quo. It is possible that the investment of these funds in other programs could result in a higher investment return to the economy.

Extension of Pass-Through Entity Elective Tax. The budget proposes to extend the state's pass-through elective tax (PTE) if the federal government extends the state and local tax payment changes enacted in the federal Tax Cut and Jobs Act of 2017. These tax policies are set to expire after 2025.

The PTE tax was created in 2021 to provide a tax benefit to Californians who were negatively impacted by the Tax Cut and Jobs Act. The program allows certain pass-through entities to elect to pay an elective tax of the entity's partners, who would then receive a tax credit equal to the elective tax amount. The pass-through entities that can participate are S corporations, general partnerships, limited liability partnerships, or limited partnerships. The pass-through entity cannot have a partnership as an owner and cannot be a publicly traded partnership.

The PTE tax has been financially beneficial both to the individuals participating in the program and the state's General Fund. Generally speaking, increased participation in the PTE results in revenue gains to the state because there are some taxpayers who do not have enough tax liability to use all of the allowable tax credits, but these individuals still participate because the reduction in their federal taxes is greater than the amount of credit they use at the state level. Over the past two years, the PTE has led to a net positive revenue gain of $300 million General Fund.

Wildfire Settlements Proposed for Income Exclusion. The budget proposes to exempt all wildfire settlements from state taxation for settlements paid in tax years 2025 through 2029, regardless of when the fire occurred. This proposal is similar to some made by Republicans in the past that were not enacted, such as SB 542 by then Senator Brian Dahle in 2024, which would have excluded settlement payments made in connection with the 2021 Dixie Fire or the 2022 Mill Fire. This proposal is a welcome move to align with those previous efforts, but the policy should also apply to Californians victimized by past fires.

Housing and Homelessness

Key Points

- **Facing an Insurance and Housing Crisis, Budget Fails Californians.** Governor Newsom fails to prioritize housing amid an insurance crisis, proposing no insurance policy reforms or new funding for housing production.
- **New Housing and Homelessness Agency.** Proposes yet another bureaucratic expansion with the creation of a new agency, the California Housing and Homelessness Agency.
- **Housing Policy Principles Outlined**. Budget outlines "policy principles" intended to increase housing development, but no specific details are provided.
- **Homeless Population Continues to Grow.** New federal data shows California has 187,000 homeless individuals, an increase of three percent over 2023.
- **Homelessness Worsening Despite Billions Spent.** A 58 percent increase in homelessness since the Governor took office, despite spending $27 billion during that time.
- **Lack of Funding for Local Governments**. Budget fails to provide flexible funding for local governments' homeless programs, resulting in fiscal and program uncertainty.
- **Behavioral Health Program Provides Rent to the Homeless**. The state has recently received approval to provide a new set of behavioral health services to the homeless.

Housing

Governor Fails to Prioritize Housing or Reform Amid Insurance Crisis. The homeowners' insurance crisis is making it more difficult to build and buy affordable homes in California. Access to homeowners insurance and mortgage insurance provides access to mortgage credit for homebuyers. After disasters like the recent Southern California wildfires, a homeowner's insurance claim payout can help the homeowner rebuild, preserving hard-earned home equity after a traumatic event.

As home prices remain elevated at historically high levels, rising insurance premiums are also contributing to the growing costs of housing development and homeownership. Lack of insurance availability is restricting the supply of housing, driving up housing costs and restricting low-price options, such as condominiums and multi-family housing. This only gets worse after each wildfire disaster, as the state will soon experience in Southern California.

Although Insurance Commissioner Lara recently released regulations intended to improve the financial viability of insurance providers, changes in the marketplace will be slow to materialize, and it could be several years before the market improves sufficiently to positively impact housing development. It is likely these regulatory changes will not be enough to fix the mess that Commissioner Lara has made, and more will need to be done to shore up the state's insurer of last resort (the FAIR Plan, see information below), reduce risk of exposure for insurance providers, and reduce costs to consumers.

California FAIR Plan - State's Insurer of Last Resort. Californians unable to find or afford insurance elsewhere in the market may turn to the state's insurer of last resort, the California Fair Access to Insurance Requirements Plan (FAIR Plan), a not-for-profit catastrophe insurer that currently holds more than 400,000 policies as of June 2024. The FAIR Plan was created by state law in 1968. It is funded primarily through the policies it sells and is jointly backed by all carriers in the admitted market (companies licensed and backed by the state to write policies in the state). Each member company shares in the profits, losses, and expenses of the FAIR Plan in direct proportion to its market share of business written in California. FAIR Plan policies provide basic, “bare bones” coverage of property damage due to fire, lightning, smoke, or internal explosions. The FAIR plan does not receive any General Fund support at this time, and it is not clear how much financial exposure the FAIR plan has for LA-area fires.

Budget Fails to Provide New Funding for Housing Programs. The January budget does not include any new funding for the state’s housing programs. Several of the state’s housing programs have federal or bond funding provided in 2025-26, such as $275 million for the Multi-Family Housing program, but these funds are minimal compared to the billions of General Fund dollars provided over the past four years.

Continued Bureaucratic Growth with New Housing and Homelessness Agency. Although the budget does not prioritize funding for housing programs, Governor Newsom does propose yet another bureaucratic expansion with the creation of the California Housing and Homelessness Agency. The proposal would move through the formal governmental organization process overseen by the Little Hoover Commission, and few details are available at this time. It is refreshing to see the Administration utilize the Little Hoover Commission’s Planned Reorganization process, as the Commission will provide a thorough analysis of the proposed new organization, but continuing to expand bureaucracy (a common theme of this Governor’s tenure) will likely result in higher ongoing costs.

No Details, but Housing Policy Principles Outlined. The budget outlines “policy principles” intended to increase housing development as a way to reduce the cost to build, improve accountability, and advance policies that promote climate change initiatives, such as transit-oriented housing development. It remains to be seen, however if the Governor will release specific language aimed at these principles or if the budget rhetoric is just intended to mitigate the obvious concerns for the lack of progress in addressing the state’s housing crisis.

<u>Homelessness</u>

Billions Spent and Homeless Continue to Grow. In an August 8, 2024, release from Governor Newsom’s press office, the Administration estimates the state has spent more than $27 billion on homelessness prevention efforts since the Governor took office. Yet despite the exorbitant amount spent on the issue, the state’s homeless population continues to increase. In 2016, California had just over 118,000 homeless, ballooning to more than 187,000 by January 2024, an increase of nearly 68,000 Californians (as noted in a December 2024 report by the federal Housing and Urban Development). To recap his time in office, the Governor has spent $27 billion dollars and the state’s homeless population has increased 58 percent, recording the highest number of homeless individuals ever.

Budget Fails to Provide New Flexible Funding for Local Governments’ Homelessness Programs. The Governor’s budget fails to include any new General Fund in 2025-26 for the Homeless Housing Assistance and Prevention program, which provides flexible funding necessary to support local governments’ homelessness efforts. The budget states that the Administration will increase accountability efforts around further implementation of these flexible homeless funds, and outlines examples such as in-depth local reviews, regional meetings, and increased enforcement.

While the budget does not include specifics on additional accountability metrics, or how the measures would improve long-term outcomes, the Governor indicates that if the Legislature supports additional funding for homelessness efforts, stricter accountability measures would be required for approval of the funding. Improving accountability of state and local efforts, and identifying how tens of billions of dollars have been spent is a laudable goal. In fact, Senate Republicans have been calling for improved accountability within the program for years, and recently, a report provided by the California State Auditor identified significant concerns with the state's lack of an actionable homelessness plan, as well as failure on the state's part to collect accurate, complete, and comparable financial and outcome information from homelessness programs.

Accountability works best in tandem with targeted and continuous support, and the Governor fails to provide this reassurance to the state's local governments, nor does his budget propose improvements in the state's ability to provide actionable intelligence on homelessness spending to date or a long-term plan to improve outcomes across all programs.

Encampment Resolution Grant Program. The budget includes $100 million General Fund for the Encampment Resolution Grant Program, which provides grant funding to assist local governments with resolving critical encampment concerns and transitioning individuals into safe and stable housing. Combined with new legal tools available following the U.S. Supreme Court's recent *Grants Pass* ruling, the program could provide local governments with resources necessary to enable the prioritization of clean-up efforts, but ongoing oversight of performance and outcome measures will be critical in subsequent years to ensure the program is an effective tool in supporting efforts to reduce homelessness.

Since 2022, the state has provided more than $735 million to local entities for the encampment resolution program, and yet the number of chronically homeless living on the streets continues to increase. Recent federal 2024 data shows 66 percent of California's homeless are unsheltered, meaning in 2024, more than 123,000 homeless were living on the streets. Unfortunately, the percent of unsheltered homeless has remained unchanged in California since 2016, despite the state spending $27 billion to manage the crisis. Californians deserve safe streets where families can walk without encountering homeless tent cities on every street corner, and the state needs to ensure that the billions of dollars spent on homelessness efforts are making strides towards that goal.

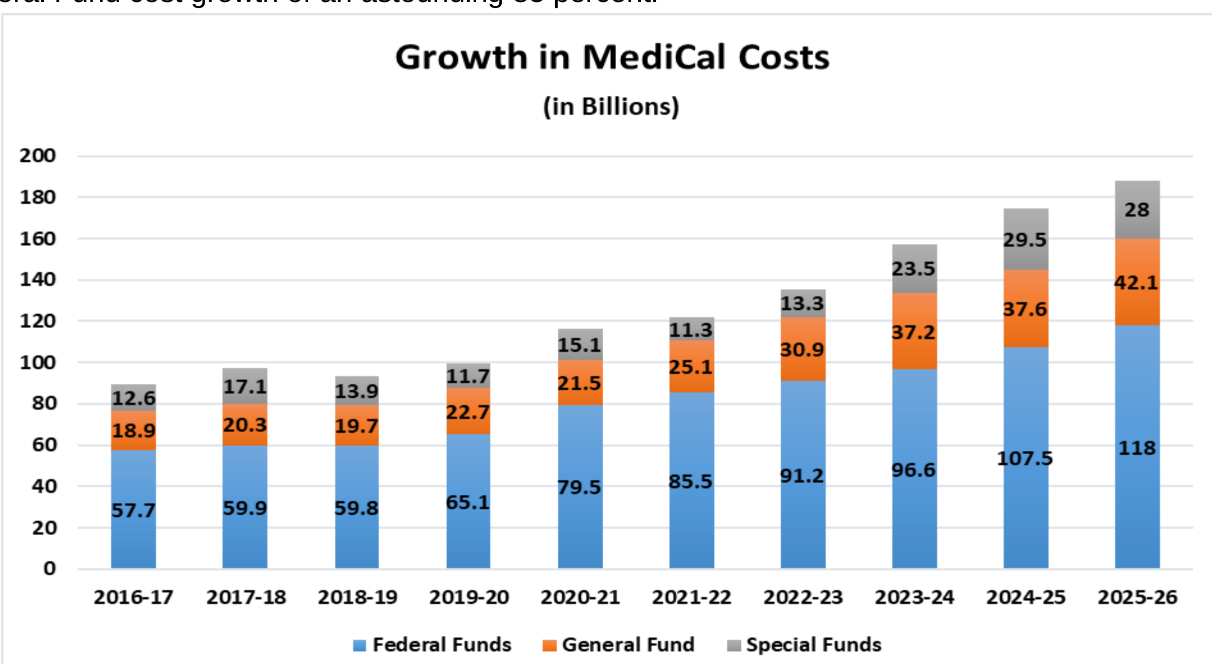
Federally Funded Behavioral Health Program Provides Six Months' Rent to the Homeless. The Department of Health Care Services recently received approval from the federal government to provide a new set of behavioral health services over the next five years. The program is called Behavioral Health CONNECT, and the majority of the program's funding is coming from the federal government. Of these new services, the most notable is the requirement for Medi-Cal managed care plans to pay up to six months of rent for certain high-need enrollees who are homeless or are at risk of homelessness. This new benefit becomes available on July 1, 2025. While this benefit has the potential to provide temporary stability to individuals in need of care who are currently living in dangerous encampments, it also perpetuates the rigid "housing first" mentality, whereby addictions are ignored in the name of finding shelter. Given the ever-growing danger of fentanyl overdoses in California, moving an individual's mental illness or drug problem indoors may do very little to improve their outcome.

Health

Key Points

- **Higher Caseload, Pharmacy Spending Result in Record Medi-Cal Costs.** General Fund expenditures in Medi-Cal increase by more than $7 billion over 2024 Budget Act.
- **Medi-Cal Expansion to the Undocumented More Costly than Expected.** Democrats' expansion of Medi-Cal to 1.5 million undocumented individuals adds billions more in spending than planned.
- **Troubling Delay in Implementation of Proposition 35 Medi-Cal Rates.** Governor chooses to delay until 2026 the proposition's requirement to fully use Managed Care Organization tax (MCO tax) revenues for increased Medi-Cal provider rates.
- **New Federal Funds for Hospitals to Pay for Wage Mandate.** The Governor relies on $6 billion in new federal funds to cover costly healthcare wage mandate.
- **Free Diapers for All Newborns.** Governor creates a new state program to give three months of free diapers to all families with newborns, regardless of income level**.**

Caseload and Pharmacy Spending Drive Medi-Cal Costs Upward. The 2024 Budget Act projected a Medi-Cal caseload of 14.5 million individuals at a cost of $161 billion ($35 billion General Fund). The Governor's budget now projects caseload for the current 2024-25 fiscal year to be 15 million individuals at a cost of $175 billion ($38 billion General Fund). In the upcoming 2025-26 budget year, the Governor estimates costs to balloon to $188 billion ($42 billion General Fund, $7 billion more than the amount in the June 2024 budget). In addition to the caseload growth, the Governor predicts $1.5 billion in new Medi-Cal pharmaceutical costs through 2025-26, citing the popularity in new anti-obesity drugs. As reflected in the chart below, although much of the program cost growth is attributable to a massive influx in federal funds into the program, the General Fund impact in 2025-26 is now at a record $42 billion. During the Newsom administration, total costs for Medi-Cal have grown by $88 billion, including General Fund cost growth of an astounding 85 percent.



Costs of Medi-Cal Eligibility Expansion to the Undocumented Greater than Estimated. Over the past 10 years, the Democrats have incrementally (by age cohort) authorized full-scope Medi-Cal eligibility (including In Home Supportive Services) to an estimated 1.5 million individuals residing in California illegally. The 2024 Budget Act estimated $5.6 billion in General Fund costs to cover this expansion. Now the Governor is estimating that the annual General Fund costs are $2.8 billion higher than planned at $8.4 billion for 2025-26, citing higher-than-anticipated enrollment and increased pharmacy costs. The chart below displays the estimated cost growth of funding this expansion over time. Had this expansion never occurred, it can be argued that the Governor's budget would not need to rely on a $7.1 billion withdrawal from the Budget Stabilization Account (the state's rainy day fund) to be balanced. Notably, Governor Newsom and legislative Democrats proceeded with these expansions with no delays even after realizing the budget surpluses had disappeared.

Annual Costs of the Medi-Cal Expansion to the Undocumented Population (in billions)										
Age Cohort	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	Totals
0-18	1.0	0.9	0.5	0.5	0.3	0.6	0.5	0.4	0.5	0.6	**5.8**
19-25	N/A	N/A	N/A	0.1	0.3	0.4	0.5	0.5	0.4	0.4	**2.6**
26-49	N/A	N/A	N/A	N/A	N/A	N/A	N/A	1.2	2.9	4.5	**8.6**
50+	N/A	N/A	N/A	N/A	N/A	0.1	0.6	1.7	1.8	2.9	**7.1**
Totals	**1**	**0.9**	**0.5**	**0.6**	**0.6**	**1.1**	**1.6**	**3.8**	**5.6**	**8.4**	**24.1**

Delay of Full Proposition 35 Implementation Could Irk Some Medi-Cal Providers. Proposition 35, the November 2024 election ballot proposition approved by the voters and supported by a large coalition of Medi-Cal providers, permanently authorizes the state to impose a Manage Care Organization tax (MCO tax), but restricts the use of the MCO tax proceeds to Medi-Cal provider reimbursement rate increases, thereby barring future legislatures and governors from shifting the MCO tax funds for a General Fund budget solution. With its approval, many Medi-Cal providers, such as primary care physicians and hospitals, will earn more for serving Medi-Cal patients.

However, despite 68 percent of voters supporting Proposition 35, the Governor's budget fails to present a full implementation plan for the provider rate increases. Instead, the Governor proposes to defer any plan to the decisions of a Medi-Cal provider stakeholder group, with any negotiated rate increases taking effect in 2026. In doing so, the Governor uses this delay to take an additional $1 billion of MCO tax revenue for General Fund relief in the current 2024-25 fiscal year, basically one last grab at the money. This could be challenged by the coalition that brought Proposition 35 to the ballot, as it seems to violate the spirit of the proposition. Senate Republicans call on the Governor and Democrats to stop the fund raids and use the money for improving Medi-Cal as the voters intended.

Federal Funds from Hospital Quality Fee to Cover Minimum Wage Mandate and Potentially Help Stabilize At-Risk Hospitals. In 2024, the Governor and the Democrats delayed implementation of the minimum wage mandate imposed on hospitals in SB 525 (2023) until October 2024 due to the estimated $2 billion annual cost. They also announced that an expanded Hospital Quality Assurance Fee (HQAF) would be collected in 2025 in order to increase the drawdown of federal funds to pay for the mandate.

The Governor's budget estimates that this expanded HQAF will generate $6 billion in enhanced federal funding in 2025, enough to both cover the cost of the minimum wage increases and to improve the operational stability of hospitals through directed payments. While help for hospitals is long overdue, the reliance on another federal funding mechanism is not sustainable in the long term, especially since the wage mandates are permanent and that President Trump has signaled that unlimited federal spending must be curtailed. If the federal government does not approve of the HQAF, the General Fund could be on the hook for the costs of SB 525, and many hospitals would continue to be in a precarious financial situation. Senate Republicans will fight for at-risk hospitals by rejecting costly mandates and ensuring that state resources are being prioritized to avoid hospital closures and financial instability.

Free Diapers for All Newborns. The Governor proposes the creation of a new state program to supply three months of diapers for every family with a newborn baby. The Governor proposes using $7.4 million in General Fund in 2025-26 and $13 million in future years to cover this new benefit, which would be implemented through state contracts with hospitals. Legislators may question whether this program should be open to all Californians or should be limited to those families truly in economic need. It is also unclear how this proposal would overlap with existing health and human services entitlements and recent state efforts to fund non-profit diaper banks.

Behavioral Health

Key Points

- **$900 Million More for Behavioral Health from "Millionaires' Tax" Revenue.** Increases in the Personal Income Tax revenue expands the amount of funding available for the Behavioral Health Services Act (BHSA).
- **Funding for Proposition 1 Implementation Included in Governor's Budget, but Nothing for Proposition 36.** The Governor's budget funds the counties' Proposition 1 implementation costs for new treatment services, but fails to provide specific funding for court mandated drug treatments arising from Proposition 36 related arrests.
- **Six Months of Rent Available to the Homeless.** The state's new Behavioral Health CONNECT program, funded largely with federal dollars, will provide transitional rent to eligible mentally ill homeless individuals.

More Behavioral Health Funding from "Millionaires' Tax" Revenue. The Mental Health Services Act, passed as Proposition 63 in 2004 (and reformed by Proposition 1 in 2024 as the Behavioral Health Services Act [BHSA]), imposes a 1 percent tax on personal income in excess of $1 million in order to fund state and county behavioral health programs. The forecast within the Governor's budget displays a significant increase in BHSA revenues as compared to the June 2024 Budget Act, as shown in the following chart.

Increase in Projected BHSA "Millionaires" Tax Revenue			
(Dollars in Billions)	**2023-24**	**2024-25**	**2025-26**
Estimates at 2024 Budget Act	**$2.5**	**$2.8**	**$2.9**
Governor's Proposed 2025-26 Budget	**$2.8**	**$3.2**	**$3.6**

Because of the increase in BHSA revenue, the Governor's budget estimates that nearly $900 million more is available for behavioral health programs than estimated in June 2024. Despite this positive news, it should be noted that the recent spike in personal income tax revenue is largely driven by capital gains realizations, a very volatile revenue source. As such, the Governor is proposing reforms to the BHSA reserve requirements in an upcoming budget trailer bill, but details of these reforms are not yet available.

Counties Get Proposition 1 Funding, but No Dollars for Proposition 36. The 2024 Budget Act provided $85 million ($50 million General Fund) for counties to begin administering the behavioral health treatment reforms found within Proposition 1, which was crafted and heavily backed by the Governor and approved by the voters in March 2024. The Governor's budget for 2025-26 continues to provide implementation funding at an amount of $94 million ($55 million General Fund). As outlined in Proposition 1, these funds will be used to focus behavioral health treatment services on the homeless or those at risk of homelessness.

While the Prop. 1 funding for counties is welcome, unfortunately the Governor's budget does not provide any new funding to implement Proposition 36, the public safety-focused proposition opposed by the Governor, but approved overwhelmingly by nearly 70 percent of the voters in November 2024. Proposition 36 permits courts to mandate drug treatment for criminal offenders with substance use disorders. Most counties will rely on their behavioral health departments to administer the mandatory treatment.

Given the tremendous need to help treat tens of thousands of mentally ill and addicted individuals living on California's streets, total behavioral health funding is likely a fraction of what is actually needed for the counties. The Governor appears to be cynically funding the proposition he supported and neglecting the one he did not. Senate Republicans heard the clear message from the voters and will work to secure Proposition 36 implementation funding for mandatory drug treatment.

New Behavioral Health Program Provides Six Months' Rent to the Homeless. The Department of Health Care Services recently received approval from the federal government to provide a new set of behavioral health services over the next five years. The program is called Behavioral Health CONNECT, and the majority of the program's funding is coming from the federal government. Of these new services, the most notable is the requirement for Medi-Cal managed care plans to pay up to six months of rent for certain high-need enrollees who are homeless or are at risk of homelessness. This new benefit becomes available on July 1, 2025.

While this benefit has the potential to provide temporary stability to individuals in need of care who are current living in dangerous encampments, it also perpetuates the rigid "housing first" policy, whereby addictions are ignored in the name of finding shelter. Given the ever-growing danger of fentanyl overdoses in California, moving an individual's mental illness or drug problem indoors may do very little to improve their outcome. Despite this, it is unlikely that the benefit will be going away in five years, putting the General Fund at risk for future costs.

Department of State Hospitals' Caseload Down, Costs Flat. The Department of State Hospitals (DSH) is responsible for the daily care and mental health treatment of more than 8,500 patients in five main hospital campuses and in dozens of contracted facilities throughout the state. Over the last decade, the population demographic has shifted from primarily civil court commitments to a forensic population committed through the criminal court system.

While the 2025-26 budget estimates that caseload will decrease to 8,527 patients from 9,267 in 2024-25, the Governor projects costs of $3.4 billion ($3.2 billion General Fund), $3.4 million higher than the 2024 Budget Act. The department attributes the caseload decrease to a decline in transfers of mentally ill inmates from the Department of Corrections and Rehabilitation. Given the caseload decline, there is enough physical bed space at the state hospitals to serve the 675 patients still pending placement. Sadly, the department's staff position vacancy rate is so high, there are not enough personnel to activate the treatment beds. Despite the overwhelming political support from state public employee unions representing nurses and psychiatrists, the Democrats still persist in neglecting the staff vacancy rate problem at the Department.

Human Services

Key Points

- **Expansions from Recent Years Continue to Drive Costs Up.** Reflects billions of dollars in cost increases from expansions of recent years, including to the In-Home Supportive Services and Child Care programs.
- **Modest Increases Proposed.** Proposes several small increases, including a cost adjustment for CalWORKs aid payments and system improvements for CalFresh.
- **CalWORKs Federal Pilot Program.** California was selected to participate in a six-year federal pilot to test performance and accountability alternatives in the CalWORKs program.
- **IHSS Cost and Caseload Growth.** The budget includes $29 billion ($11 billion General Fund) in 2025-26 for the IHSS program, with a projected average caseload of 771,650 in 2025-26.

Department of Social Services

The 2025-26 local assistance budget for Department of Social Services (DSS) is projected to be over $62 billion ($23 billion General Fund). This is $5 billion ($3.1 billion General Fund) more than the 2024 Budget Act. The department notes that benefits are currently provided to over 7.9 million Californians. Several programs now are experiencing enrollment growth near or exceeding 9 percent, as seen the chart below:

Department of Social Services Caseload Projections

Program	2024 Budget Act	2024-25 Revised	2025-26 Projected	Change From 2024 Budget Act to 2025-26 Projected	
				Amount	Percent
CalFresh	3,089,948	3,194,505	3,228,219	138,271	4.5
Supplemental Security Income/State Supplementary Payment (SSI/SSP)	1,076,332	1,086,694	1,078,708	2,376	0.2
In-Home Supportive Services (IHSS)	703,921	717,814	771,650	67,729	9.6
California Work Opportunity and Responsibility to Kids (CalWORKs)	354,772	359,786	361,834	7,062	2.0
CalWORKs Child Care	141,062	147,267	153,340	12,278	8.7
Child Welfare Services	111,518	109,915	110,903	-615	-0.6
Adoption	87,087	86,591	86,702	-385	-0.4
California Food Assistance Program (CFAP)	58,838	62,254	64,538	5,700	9.7
Foster Care	45,358	43,367	42,299	-3,059	-6.7
Kinship Guardianship Assistance Payment Program (Kin-GAP)	17,609	17,436	17,336	-273	-1.6
Cash Assistance Program for Immigrants (CAPI)	15,976	16,556	17,339	1,363	8.5
Total*	**5,702,421**	**5,842,185**	**5,932,868**	**230,447**	**4.0**

*Note: The total projected caseload is not unduplicated. This means that an individual could be included twice if they are receiving benefits from more than one program. The total caseload for programs such as CalWORKs and CalFresh do not account for how many individuals are being served per case. The table also does not include figures for services such as non-CalWORKs Child Care and Development programs, Housing and Homelessness programs, and Immigration Legal Services.

The Governor's budget foregoes substantial new proposals for Human Services programs, but major expansions authorized in recent years continue to drive costs higher by billions of dollars annually. These expansions and new proposals are detailed below:

In-Home Supportive Services (IHSS)

Caseload and Cost Growth in IHSS. The budget includes $29 billion ($11 billion General Fund) in 2025-26 for the IHSS program, reflecting a $3.3 billion ($1.4 billion General Fund) increase compared to the 2024 Budget Act. The department notes that the increase in costs reflects continued projected caseload growth, cost per hour, and number of hours per case for IHSS overall. Estimates put the projected caseload at 771,650 in 2025-26, representing a 9.6 percent increase over the 2024 Budget Act. The average individual provider hours per case are projected at 123.7 in 2025-26. For comparison, at the 2021-22 Governor's budget, the average individual provider hours per case were 115.2 for 2020-21.

California Work Opportunity and Responsibility for Kids (CalWORKs)

CalWORKs Budget and Caseload. The budget proposes $6.4 billion total funds ($961 million General Fund) in 2025-26 for CalWORKs program expenditures, an increase of $50 million total funds ($536 million General Fund) from the 2024 Budget Act. The average monthly caseload is estimated at 361,834 families. This represents a 2 percent increase over the 2024 Budget Act caseload of 354,772. The total CalWORKs funding does not include CalWORKs Stage One Child Care and CalWORKs housing programs, which area accounted for in the child care and social services housing sections. The increase in General Fund is due to a lower amount of Federal Temporary Assistance for Needy Family (TANF) carryforward funds available in 2025-26.

CalWORKs Grant Increase. The Governor's budget includes a 0.2 percent increase to CalWORKs Maximum Aid Payment levels, estimated to cost $9 million. This increase is supposed to be funded entirely by the Child Poverty and Family Supplemental Support Subaccount, a fund source that the state previously realigned to counties. While this expansion is being covered by the subaccount, it should be noted that if the subaccount ever has insufficient funding to cover this increase or any prior grant increases, General Fund will be used to backfill the difference.

CalWORKs Federal Pilot Program. California was selected as one of five states to participate in a federal pilot program that seeks to test alternative benchmarks to work participation rates. This means California's entire CalWORKs program will be operating under alternative accountability measures. The pilot will be in place for six federal fiscal years, with first year being used to establish benchmark data and negotiate performance targets. The following five years will be used to measure the programs performance against those new targets. While details are still being worked out on how the state will advance the goals of the pilot project, prior authorizations were provided to DSS to consider proposals to modify the existing welfare-to-work process, limit sanctions, and repeal the federal work participation rate penalty pass-through.

Over the past decade, numerous policy changes have been passed that have significantly altered accountability metrics in CalWORKs, including the elimination of the Maximum Family Grant rule, extension of the lifetime limits for adult recipients from 48 to 60 months, and increased "flexibility" in work participation requirements. That said, with the selection of California for the pilot program, the state will have an opportunity to test alternative benchmarks without the threat penalties for failing to meet work participation rates. The alternative benchmarks could potentially provide a better picture of CalWORKs outcomes, shortcomings, and what works to improve family outcomes.

Food and Nutrition Programs

CalFresh Program Integrity Improvements. The Governor's budget includes $7.6 million ($2.7 million General Fund) for automation costs related to utilizing the Supplemental Nutritional Assistance Program (SNAP) National Accuracy Clearinghouse (NAC). The federal government is requiring that all states utilize the NAC to enhance SNAP integrity, known as CalFresh in California. The program uses interstate data matching to help prevent households from receiving benefits in multiple states at the same time. The department anticipates using the NAC beginning in November 2026.

Children and Family Services

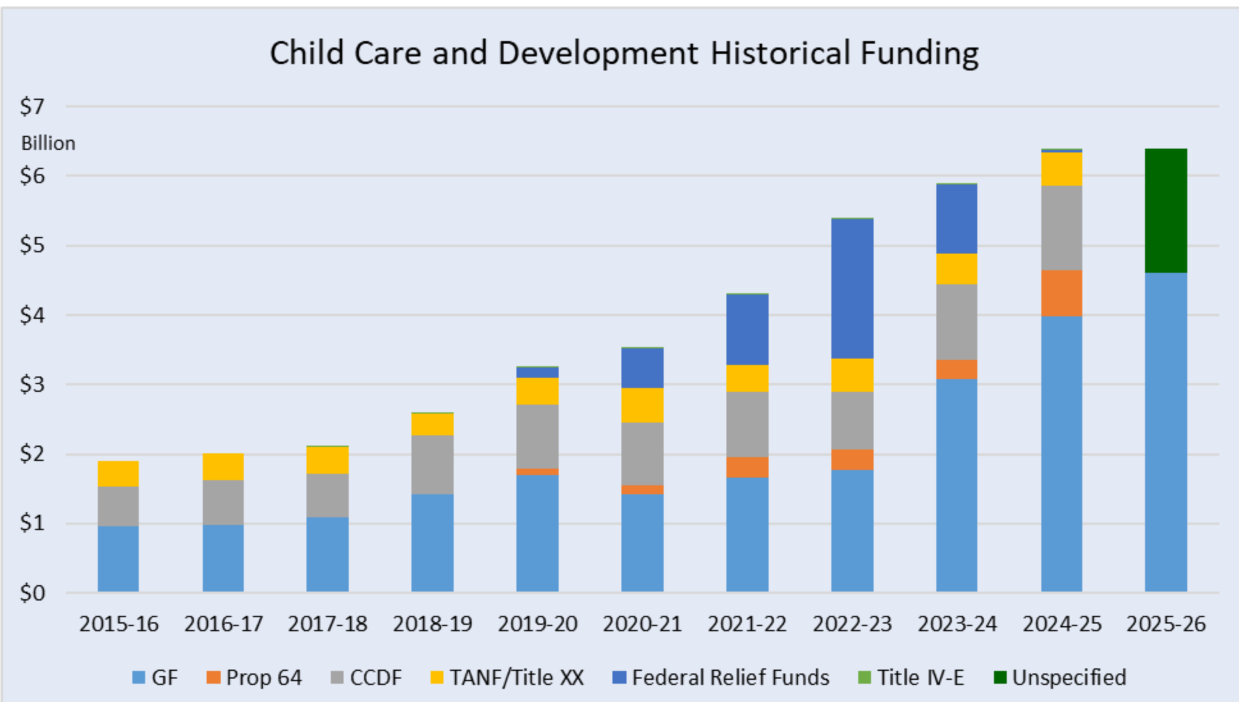
Tiered Rate Structure Implementation Preparation. The Governor's budget includes $1.7 million ($1.2 million General Fund) for Child and Adolescent Needs and Strengths (CANS) Fidelity and Training activities. These activities will be in preparation for the rollout of the new permanent tiered rate structure for foster care. Under the new structure, rates will be based on the needs and strengths of a child or youth, rather than their placement type. The CANS tool will be used to determine the tier of the child or youth, and ensuring proper training is essential to maintaining reliability in the use of the tool.

Child Care and Early Education

Key Points

- **Potentially Major Costs for New Bargaining Agreement.** The Administration is still in negotiations with Child Care Providers United on a new bargaining agreement, with costs potentially in the low billions of dollars.
- **Additional Billions in Costs Possible from New Rate Setting.** The state is moving to set new reimbursement rates under an alternative methodology by July 1, 2025. Prior estimates put the full implementation cost of the alternative methodology in the lows tens of billions of dollars.
- **California State Preschool Program.** The Governor's budget includes $2.9 billion ($1.9 billion Proposition 98 General Fund and $1 billion Non-Proposition 98 General Fund) for the California State Preschool Program.

Child Care Overall Budget. The 2025-26 budget proposes $6.4 billion ($4.6 billion General Fund) for child care programs administered by DSS, including CalWORKs Stages One, Two, and Three, Alternative Payment Programs, Migrant Child Care, General Child Care, Child Care for Children with Severe Disabilities, the Emergency Child Care Bridge Program, and local supports for the programs. This reflects an increase of $777 million General Fund over the 2024-2025 budget appropriation. Below is a chart showing historical child care and development funding by source. An exact breakdown of funding for 2025-26 was not available at the time this report was written.



CCDF is the federal Child Care and Development Fund, Tittle IV-E is federal funding related to Foster Care, Proposition 64 is Marijuana Tax Funding, and TANF/Title XX is the federal Temporary Assistance for Needy Families and Social Services funding.

Potentially Major Costs for New Bargaining Agreement. The Administration is still in negotiations with Child Care Providers United on a new bargaining agreement. The current bargaining agreement is set to expire on June 30, 2025, and while no cost estimates have been provided, the prior bargaining agreement resulted in costs exceeding $2 billion over two fiscal years. Complicating the situation, the focus of the new bargaining agreement is centered on the implementation of an alternative methodology to set child care reimbursement rates, as discussed in the following paragraphs.

Additional Billions in Costs Possible from New Rate Setting. Simultaneously with the new bargaining agreement, the state is moving to set new reimbursement rates under an alternative methodology by July 1, 2025. Final details on the cost and implementation of the alternative methodology are still in flux. The department noted in a recent report to the Legislature that, "Additional aspects of the single rate structure's final design will be determined through the 2025-2026 budget development process, and those that are applicable to family child care providers will be negotiated in accordance with the collective bargaining process. Rate Setting informed by the alternative methodology will also be determined through these upcoming processes."[12]

Prior estimates put the full implementation cost of the alternative methodology in the lows tens of billions of dollars. It should be noted that while the budget requires the Governor and Legislature to establish rates based on the methodology, there is no requirement to fully or partially fund the rates based on the methodology. A recent report by the nonpartisan Legislative Analyst's Office shows child care to be one of the fastest growing major programs in the state, with a growth rate of about 20 percent. If the push to fund child care rates at the alternative methodology continues, General Fund spending on child care will grow at an even more startling rate.

California State Preschool Program (CSPP). The Governor's budget includes $2.9 billion ($1.9 billion Proposition 98 General Fund and $1 billion Non-Proposition 98 General Fund) for the CSPP. It should be noted that the CSPP will also utilize the new rate structure once implemented.

[1] Quarterly Implementation Report to the Legislature (January 7, 2025)

Developmental Services

Key Points

- **Funds Overdue Rate Increases to Developmentally Disabled Service Providers**. The Governor finally funds promised but long-delayed payment increases for the developmentally disabled community.
- **Master Plan for Developmental Services.** In March 2025, the Governor will release an outline for future improvements in the delivery of services.
- **Record Number of Regional Center Consumers Drives up Costs**. Nearly 40,000 more Californians to be served by the Department of Developmental Services (DDS) results in a $2.2 billion increase in General Fund costs.
- **Continues Costly “Warm Shutdown” of Fairview Developmental Center.** Despite plans to use the property for public and private sector alternatives, DDS still spends millions for facility to sit vacant.

Finally Funds Promise to the Developmentally Disabled Community. After years of prioritizing spending on the undocumented and favored unions, the Governor is finally providing funding to increase the reimbursement rates for intellectual and developmentally disabled service providers. The Governor’s budget includes $1 billion General Fund in 2024-25 and $1.3 billion in 2025-26 to implement the final year of the long-awaited service provider rate increases.
This is the final full year of a multi-year roll-out of the service rate reforms. Under the timeline the Democrats endorsed in the 2022 Budget Act, this full final year was to take place in the 2024-25 fiscal year, but in the 2024 Budget Act, the Democrats chose to break their promise to the developmentally disabled community and delayed funding by six months. This created a disruptive impact in the delivery of services, given that service providers had already made hiring decisions reliant on the July 2024 scheduled rate increase. Now with full funding, service providers can plan to scale up their workforce to effectively serve consumers.

Senate Republicans have long advocated for improving rates for those serving families with developmentally disabled individuals and for improving the quality of disabled individuals’ lives, including a comprehensive set of reforms proposed through SB 638 (Stone) in 2015. Democrats first watered down that bill before blocking its passage. Now, nearly a decade later, Senate Republicans will continue to monitor overdue improvements so as the rates are implemented.

Soon-To-Be Released Master Plan on Developmental Services. DDS is responsible for administering the Lanterman Act, which provides services and supports through a network of regional centers to enable people with intellectual and developmental disabilities to lead more independent and integrated lives. In March 2025, DDS will release a report outlining recommendations to implement a more consumer-friendly and effective service delivery model. Stakeholder groups have been meeting for more than a year to develop the plan, focusing on issues such as the tailoring of services to unique consumers and the retention of the service vendor workforce. DDS has signaled that budget proposals will be proposed in the spring of 2025 to reflect some of the recommendations in the report. As noted above, Senate Republicans previously proposed comprehensive reforms nearly a decade ago through legislation that Democrats blocked. Now Republicans will monitor the suggestions in this upcoming report and will continue to offer family-centered policy solutions to improve the quality of care for this vulnerable population.

Rapidly Growing Regional Center Caseload Driving up General Fund Costs. DDS is currently experiencing a rapidly growing regional center caseload. As shown in the chart below, the number of individuals served by regional centers is expected to reach more than 504,000 in 2025-26, a nearly

40,000 (or nine percent) increase from 2024-25. In addition, 302 individuals are projected to be served in state-operated facilities as of July 1, 2025. DDS states that much of the caseload growth is attributable to a large post-pandemic cohort of toddler-aged children entering the system.
The caseload increase is a factor in the sizable growth in General Fund costs as well. The Governor's budget includes $12.4 billion in General Fund for 2025-26, a $2.1 billion increase from 2024-25. The department projects that both caseload and costs will level off in subsequent fiscal years.

DDS Caseload and General Fund Costs			
	2024-25	2025-26	Difference
Caseload	465,165	504,905	39,740 (+8.5 %)
General Fund (in billions)	$10.3	$12.4	$2.1 (+ 21.2%)

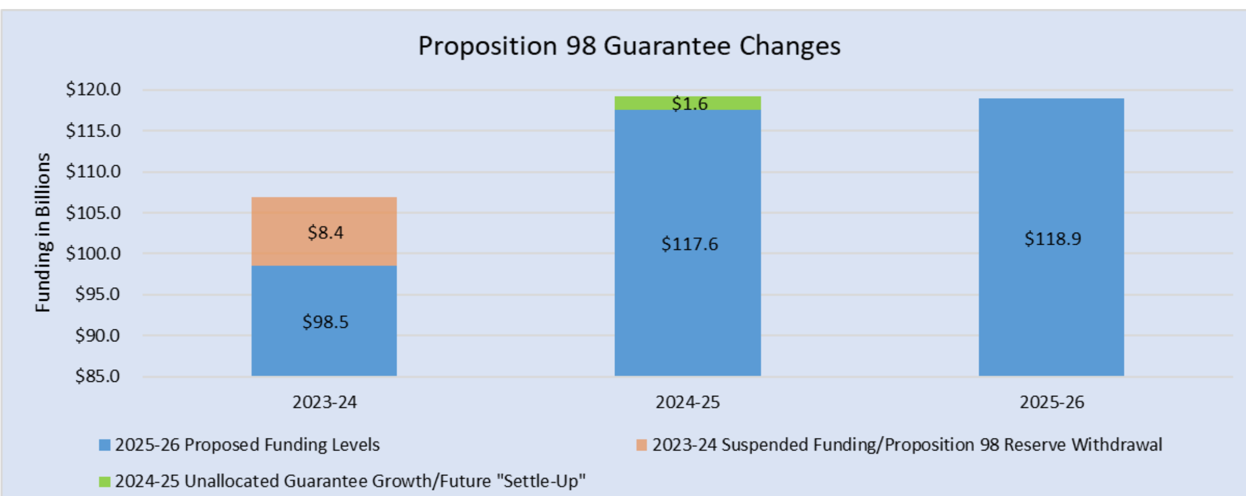
Continues "Warm Shutdown" of Fairview Developmental Center. The Governor's budget includes yet an another extension of the warm shutdown funding for Fairview Developmental Center in Costa Mesa at a cost of $10.8 million General Fund to maintain 52 staff there. Even though the last resident moved out of Fairview in January 2020, the Governor is choosing to maintain the warm shutdown status of an empty facility for the sixth straight fiscal year. DDS's argument for the spending is that the facility could be needed at any time, as was the situation with the closure of the Sonoma Developmental Center over a decade ago. But this worry is exaggerated, and the use of this much money to maintain empty facilities should be a concern to the public. There are a number of better uses of this valuable property, and the state should consider ways to use this asset to help close future budget deficits.

TK-12 Education

Key Points

- **Overall Education Funding and Proposition 98 Guarantee.** Includes $137 billion for all TK-12 education programs and the Proposition 98 Guarantee for 2025-26 is $119 billion.
- **Universal Transitional Kindergarten Full Implementation.** Includes $2.4 billion ongoing Proposition 98 General Fund for the full implementation of universal transitional kindergarten.
- **Literacy Coaches and Screening Training.** Proposes $500 million one-time Proposition 98 General Fund for TK-12 Literacy and Mathematics Coaches and $40 million one-time Proposition 98 General Fund to support training educators on literacy screenings and purchasing materials.
- **New Discretionary Block Grant.** Proposes $1.8 billion one-time Proposition 98 General Fund for a Student Support and Professional Development Discretionary Block Grant.
- **School Facilities Bond Implementation.** Notes that the passage of Proposition 2 in November 2024 authorized $8.5 billion in state bonds for K-12 schools to be allocated through the existing School Facility Program.

Proposition 98 TK-14 Funding. The budget maintains a Proposition 98 funding level of $99 billion in 2023-24 for TK-12 schools and community colleges. The revised 2024-25 Proposition 98 guarantee is calculated at $119.2 billion, but the budget proposes to fund the guarantee at $117.6 billion, or $1.6 billion below that level. According to the Department of Finance, this is to provide a buffer for changes in the guarantee before the final calculations are made. If revenues remain the same, this would create a “settle-up” obligation in future years. If revenues decline, the obligation would also decline. Proposition 98 funding in 2025-26 would also be $119 billion, nearly unchanged from the calculated 2024-25 level. The table below summarizes these comparisons.



Proposition 98 General Fund spending per pupil would be $18,918 in 2025-26 and $24,764 per pupil from all funding sources. This is a Proposition 98 General Fund increase of $7,041 per pupil, or 59 percent, compared to six years ago in 2019-20, the year before the pandemic started. When accounting for all funds, it is an increase of $7,750 per pupil, or 46 percent.

Proposition 98 Funding by Segment and Source *(Dollars in Millions Except Funding Per Student)*					
	2023-24 Revised	2024-25 Revised	2025-26 Proposed	Change From 2024-25	
				Amount	Percent
K-12 Education					
General Fund[a]	$67,308	$74,849	$75,185	$336	0.4%
Local property tax	27,322	28,265	29,783	1,518	5.4%
Subtotals	**$94,630**	**$103,114**	**$104,968**	**$1,854**	**1.8%**
California Community Colleges					
General Fund	$8,198	$9,048	$9,041	-$6	-0.1%
Local property tax	4,070	4,304	4,538	233	5.4%
Subtotals	**$12,267**	**$13,352**	**$13,579**	**$227**	**1.7%**
Reserve Deposit/Withdrawal (+/-)[b]	-$8,413	$1,157	$376	-$780	-67.5%
Settle Up (Unallocated)[c]	-	$1,565	-	-$1,565	-100.0%
Totals	**$98,484**	**$119,188**	**$118,923**	**-$264**	**-0.2%**
Enrollment					
K-12 attendance	5,449,360	5,504,951	5,543,727	38,776	0.7%
Community college FTE students	1,100,665	1,100,406	1,098,636	-1,770	-0.2%
Funding Per Student					
K-12 Education	$17,365	$18,731	$18,935	$203	1.1%
California Community Colleges	11,145	12,134	12,360	226	1.9%

[a] Includes funding for instruction provided directly by state agencies and the portion of State Preschool funded through Proposition 98.

[b] Proposition 98 Reserve established by Proposition 2 (2014). Amounts consist entirely of General Fund.

[c] Represents the amount that would be allocated for schools and community colleges in the future, assuming no changes to the administration's estimates of the guarantee. Amount consists entirely of General Fund.

FTE = full-time equivalent.

Proposition 98 Rainy Day Fund. The Governor's budget estimates a $1.5 billion balance in the Public School System Stabilization Account (school reserve) at the end of 2025-26. This reflects revised deposits of $1.2 billion and $376 million in 2024-25 and 2025-26 respectively, both of which are mandatory. Under current law, there is a cap of 10 percent on local school district reserves in fiscal years immediately succeeding those in which the school reserve balance is equal to or greater than 3 percent of the total TK-12 share of the Proposition 98 guarantee. The balance of $1.2 billion in 2024-25 does not trigger school district reserve caps in 2025-26.

Local Control Funding Formula (LCFF). The budget includes a 2.43 percent cost-of-living adjustment (COLA) for the LCFF, that when combined with population growth adjustments, will result in a $2.5 billion increase in discretionary funds for schools. The budget also provides $204 million ongoing Proposition 98 General Fund for COLA adjustments for the LCFF Equity Multiplier and categorical programs such as Special Education, State Preschool, Youth in Foster Care, Child Nutrition, and the Charter School Facilities Grant Program. County Offices of Education are also provided $12 million ongoing Proposition 98 General Fund to reflect the COLA and average daily attendance changes.

Universal Transitional Kindergarten Full Implementation. The Governor's budget includes $2.4 billion ongoing Proposition 98 General Fund for the full implementation of universal transitional kindergarten. This total is inclusive of all prior years' investments, including $860 million for the 2025-26 fiscal year. The additional funding is estimated to provide access for 60,000 additional children. An additional $1.5 billion ongoing Proposition 98 General Fund would support lowering the student-to-adult ratio from 12:1 to 10:1.

School Facilities Bond Implementation. The Governor's budget notes that the passage of Proposition 2 in November 2024 authorized $8.5 billion in state general obligation bonds for K-12 schools, which will be allocated through the existing School Facility Program. The bond funding allocation is as follows:

- $4 billion for modernization projects
- $3.3 billion for new construction
- $600 million for charter schools
- $600 million for career technical education projects.

The 2024-25 budget eliminated a planned $550 million one-time General Fund investment in the Preschool, Transitional Kindergarten, and Full Day Kindergarten Facility Grant program, and another planned $875 million one-time General Fund investment in the School Facility Program, in anticipation of the bond passing. Thus, the net addition of school facilities funding would be $7.1 billion. Additional details regarding the administrative funding for the implementation of the bond will be determined through the budget process.

Literacy Coaches and Screener Training. The Governor's budget proposes $500 million one-time Proposition 98 General Fund for TK-12 Literacy and Mathematics Coaches, which adds on to $500 million one-time Proposition 98 General Fund provided in prior budgets. In addition, the Governor's budget proposes $40 million one-time Proposition 98 General Fund to support training educators on literacy screenings and other costs, such as screening materials. The 2024 Budget Act also appropriated $25 million one-time Proposition 98 General Fund for professional development related to the implementation of literacy screenings for reading disabilities in kindergarten through second grade. Finally, the budget also proposes $5 million Proposition 98 General Fund each year through 2029-30 to implement a literacy network. More information on this proposal will be available once the administration releases proposed trailer bill language.

Student Support and Professional Development Discretionary Block Grant. The Governor's budget proposes $1.8 billion one-time Proposition 98 General Fund for a new Student Support and Professional Development Discretionary Block Grant. According to available information, the funding is intended to help with rising costs, career pathways and dual enrollment expansion efforts, teacher recruitment and retention, and professional development for teachers on the frameworks in mathematics, English language arts, and literacy. Additional information on this proposal will be available when proposed trailer bill language is released.

Other K-12 Budget Adjustments. The budget also includes the following changes.

- **Expanded Learning Opportunities Program (ELOP).** The Governor's budget includes an additional $435 million ongoing Proposition 98 General Fund for the full implementation of ELOP. This would bring the total ongoing funding for the program to $4.4 billion. The budget also proposes to increase the number of Local Education Agencies that receive ELOP funding by reducing the qualifying percentage of unduplicated students at a Local Education Agency from 75 percent to 55 percent.

- **Teacher Recruitment and Professional Development.** The budget proposes $150 million one-time Proposition 98 General Fund for a new Teacher Recruitment Incentive Grant Program, and $100 million one-time Proposition 98 General Fund to extend the timeline for the existing National Board Certification Incentive Program.

- **Learning Recovery Emergency Block Grant Restoration.** The Governor's budget proposes $379 million one-time Proposition 98 General Fund for the Learning Recovery Emergency Block Grant (LRG). The block grant was cut by $1.6 billion in the 2023-24 budget, with intent language to restore $1.1 billion of the cut in future years. The proposed $379 million would be the first of three previously planned restoration payments to the block grant.

- **Local Property Tax Adjustments.** The budget includes an increase of $125 million Proposition 98 General Fund for school districts and county offices of education in 2024-25, and a decrease of $1.5 billion ongoing Proposition 98 General Fund in 2025-26 because of increased offsetting property taxes.

- **Kitchen Infrastructure and Training.** The budget proposes $150 million one-time Proposition 98 General Fund for specialized kitchen equipment, infrastructure, and training. The administration notes that this is to support schools in providing more freshly prepared meals made with locally grown ingredients. It should be noted that $150 million was provided in the 2021 Budget Act and $600 million in the 2022 Budget Act for kitchen infrastructure and training grants. An additional $15 million was also provided in the 2023 budget act for commercial dishwasher grants.

- **Continued Support for School Nutrition.** The budget proposes an increase of $106 million ongoing Proposition 98 General Fund to fully fund the universal school meals program in 2025-26. It is projected that over one billion meals will be served in 2025-26. The budget proposes $4.8 billion total funds ($1.9 billion Proposition 98 General Fund) for school nutrition programs in 2025-26.

Higher Education

Key Points

- **University Compact Deferrals Maintained.** Defers the five percent increases previously agreed upon through the compacts, including $252 million to the California State University and $241 million to the University of California to 2027-28.
- **Master Plan for Career Education.** The lone major proposal in Higher Education would provide $100 million Proposition 98 General Fund to implement Credit for Prior Learning and Career Passport initiatives under the so-called Master Plan for Career Education.
- **Community Colleges Receive Cost-of-Living Increase.** Proposes a cost-of-living increase of 2.43 percent, consistent with TK – 12 schools.

Community Colleges See Raise, but Other Higher Education Budgets Largely Flat. The state's two main university systems, the University of California (UC) and California State University (CSU) are both seeking restoration of the operating reductions of nearly 8 percent authorized in last year's budget actions. However, with a couple exceptions, Higher Education budgets are largely flat. Student financial aid would see a decline in funding of $333 million from 2024-25, as explained further below. The table reflects total funds for various Higher Education budgets.

Higher Education Expenditures
(Dollars in Millions)

	2023-24	2024-25	2025-26	Change from 2024-25 Dollars	Change from 2024-25 Percent
University of California					
Ongoing General Fund	4,717.3	4,984.6	4,984.6	$0.0	0.0%
One-Time General Fund	143.0	4.0	-	-$4.0	
Total Funds 1/ 4/	$10,602.9	$10,947.4	$11,162.5	$215.1	1.9%
California State University					
Ongoing General Fund	5,391.2	5,600.7	5,642.7	$42.0	0.7%
One-Time General Fund	35.5	5.0	0.3	-$4.7	
Total Funds 1/ 4/	$8,807.8	$9,158.5	$9,359.8	$201.3	2.2%
California Community Colleges					
General Fund & Property Taxes 4/	12,303.4	13,938.0	14,789.1	$851.1	6.1%
Total Funds 3/	$21,336.2	$21,524.3	$21,160.6	-$363.7	-1.7%
California Student Aid Commission					
General Fund 2/ 4/	2,875.5	3,135.3	2,802.3	-$333.0	-10.6%
Total Funds	$3,304.0	$3,557.3	$3,222.7	-$334.6	-9.4%
General Fund	**$24,829.8**	**$27,660.3**	**$28,393.9**	$733.7	2.7%
Total Funds	**$44,050.9**	**$45,187.5**	**$44,905.5**	-$282.0	-0.6%

1/ These totals include tuition and fee revenues and other funds the universities report as discretionary.

2/ General Fund expenditures for the Cal Grant program are offset by reimbursements, including approximately $400 million in federal Temporary Assistance for Needy Families (TANF) funds received through an agreement with the Department of Social Services.

3/ Withdrawals from the Public School System Stablization Account are reflected in this row.

4/ Savings resulting from Section 4.05 and/or Section 4.12 of the 2024 Budget Act are currently recorded as an unallocated statewide set-aside. As a result, this General Fund expenditure amount may reflect overstated expenditures.

Master Plan for Career Education Funds for Community Colleges. The Governor issued an executive order in 2023 calling for a so-called Master Plan for Career Education. The budget proposes $100 million from Proposition 98 General Fund, of which $93 million would be one-time) for community colleges to implement a Credit for Prior Learning and build infrastructure for a "Career Passport." Under this concept, students could receive recognition for non-academic experiences and skills.

Proposed funds for additional elements of this Master Plan appear in other areas of the budget, including:

- $5 million ongoing General Fund for the Government Operations Agency to establish a state planning and coordinating body for TK-12, higher education, and labor agencies.
- $4 million one-time General Fund to support regional coordination for career education and training.

While the goals of this initiative are laudable, it is not clear that the state needs yet another organization to plan and coordinate other existing agencies, or that the time for this expansion is now, given the multiyear deficits facing the state.

University Compact Deferrals Maintained. Consistent with last year's actions, the Governor's budget maintains the deferral of the five percent increases previously agreed upon through the compacts, including $252 million to the CSU and $241 million to the UC to 2027-28. The Governor argues that CSU and UC could draw down their reserves or borrow internally or externally to manage the one-year deferral. However, with multiyear deficits reaching the tens of billions of dollars annually facing California's budget, it is unlikely that UC and CSU will receive those funds a year later.

California Community Colleges: Increases for Costs and Facilities. The community college budget is part of the state's Proposition 98 education obligation and often includes similar adjustments to K-12 education. In addition to the Master Plan for Education funds mentioned above, key adjustments in the Governor's budget include:

- The Governor's budget includes $230 million ongoing Proposition 98 General Fund to provide a 2.43 percent cost-of-living adjustment for Student-Centered Funding Formula apportionments and $30 million ongoing Proposition 98 General Fund for 0.5 percent for enrollment growth. The cost-of-living adjustment is consistent with TK-12 schools under Proposition 98.

- An increase of $16 million ongoing Proposition 98 General Fund to provide a 2.4 percent COLA for select categorical programs and the Adult Education Program.

- Following the voters' enactment of the Proposition 2 education bond, the budget proposes $52 million one-time bond funds allocated for infrastructure, modernization, and enrollment growth projects for 28 community college facilities.

University of California Adjustments. The Governor's budget reflects the following reductions:

- ***Resident Undergraduate Enrollment.*** Maintains the previously authorized delay in funding of $31 million ongoing General Fund to 2027-28 for increasing resident undergraduate enrollment by 902 students across three UC campuses.
- ***General Fund operations reduction.*** Under last year's budget actions, the University of California is subject to a 7.95 percent General Fund operations reduction of nearly $397 million. The Governor's budget would maintain that cut, despite UC's request for a reversal.

Note that UC raises tuition on each incoming freshman class by 5 percent and then maintains that level for that cohort throughout their enrollment. The state budget's cuts are placing further strain on students' costs for higher education.

California State University Adjustments. Under last year's budget actions, CSU is subject to an ongoing 7.95 percent reduction in General Fund operations, equating to $375 million. The Governor's budget would maintain that cut, despite CSU's request for a reversal. Note that CSU launched a multiyear plan for recurring tuition increases of 6 percent per year through the end of the 2028-29 academic year. The state budget's cuts are placing further strain on students' costs for higher education.

California Student Aid Commission. The Governor's budget proposes financial aid expenditures totaling $3.1 billion, $2.6 billion of which supports the Cal Grant Program, and $527 million of which supports the Middle-Class Scholarship program. The state's Cal Grant program is estimated to provide over 417,000 financial aid awards to students who meet specified eligibility criteria. The Commission's budget would decline by $333 million under the Governor's budget, largely reflecting the removal of one-time funds for the Middle-Class Scholarship program and the Golden State Teacher Grant program.

College of the Law, San Francisco (Formerly UC Hastings). The Governor's budget includes $10 million ongoing General Fund for debt service associated with the second phase of the McAllister Tower student housing renovation. Despite being subject to a 7.95 percent reduction in General Fund operations of $1.8 million, the Governor's budget includes a $2.4 million ongoing General Fund base increase of 3 percent. With base increases deferred for UC and CSU, it is not clear why the College of the Law would receive a base increase.

Labor and Workforce Development

Key Points

- **California Unemployment Debt Continues to Challenge Employers.** Despite larger principal payments via increased federal employer taxes, California continues to carry a balance of $21 billion for unemployment insurance (UI) loans from the federal government.
- **UI Debt Interest Payment.** Proposes $634 million to pay the annual interest payment on the federal UI loans. A planned interest payment of $50 million from the Employment Training Fund would shift back to the General Fund.
- **UI Reforms.** The Legislative Analyst proposes policy changes to the UI tax structure that, if adopted, would dramatically raise employer taxes to address the UI debt.
- **Employment Development Department (EDD) Modernization.** Includes $124 million in funding for EDD IT systems, improved service for claimants, and fraud prevention, continuing a five-year modernization plan initially funded in 2022-23.

California UI Debt Continues to Challenge Employers. California remains one of only two states to have neglected to pay off its UI debt to the federal government following the pandemic (New York is the other). California's debt balance of $21 billion continues to grow despite increased payments via employer taxes, reflective of continued borrowing to pay benefits. Employers must pay down the debt principal through increased federal employer taxes, which ratchet up each year until the debt is paid off. This year employers will pay a total of $63 more per employee, when compared to a baseline with no UI debt. Next year the tax will increase another $21 to $84 for each worker.[3] Governor Newsom likes to claim he does not support broad tax increases, but by refusing to pay off California's UI debt when a surplus was available, the Governor and other Democrats chose to let those tax increases go into effect.

UI Debt Interest Payment. While increased federal employer taxes pay down the principal on the federal UI loans, the state is responsible for the interest payments. The proposed budget includes $634 million General Fund to pay the annual interest payment. Previously, the Governor planned to use $50 million from the Employment Training Fund (paid by employers) to cover a portion of the 2025-26 payment and reduce costs to the General Fund. However, after the current year $100 million interest payment from this fund, the Governor's administration determined further interest payments would require reductions to employment training programs meant to create a skilled and productive workforce. This portion of the payment is now included in the General Fund amount. As noted above, these interest payments would have been avoided entirely if the Governor and legislative Democrats had done what nearly every other state did: using past surplus funds to pay off the federal loan.

UI Reforms. In December 2024, the nonpartisan Legislative Analyst's Office (LAO) published a report outlining the continued structural deficit within the UI fund and made four recommendations to fix the UI system.

- Substantially increase the taxable wage base from $7,000 to $46,800, a 569 percent increase.
- Redesign employer tax rates using a Standard Rate and a Reserve-Building Rate, and apply these rates to the higher recommended taxable wage base of $46,800.

[3] This reflects a total federal tax of $105 per employee for the 2024 taxable year and $126 per employee for the 2025 taxable year, with taxes for each year due the following January. Absent a UI debt, employers pay $42 per employee in federal taxes.

- Change to an experience rating system that bases employers' tax rates on increases or decreases in employment, rather than their former workers' UI costs, as the current system operates.
- Refinance the existing federal loan and split the repayments between employers and the state.

The LAO notes that raising the taxable wage base alone would not address the state's UI solvency issue. However, implementing all four of these recommendations would significantly increase taxes on businesses. The LAO indicates that an employer currently pays about $250 per year in UI taxes per employee. Under existing law, this amount would gradually increase to about $450 in the coming years to repay the federal UI loan. Under the LAO's recommended reforms, the same employer would pay about $700 annually for a minimum wage employee and $1,000 annually for an employee making more than $46,800.

Obviously, such a large tax increase would be cause for great concern within the business community. And if history is any indication, a healthy UI fund with reserves would tempt California Democrats to cave to union demands for expanded benefits, further raising program costs and driving a need for even higher taxes. Presumably any reform efforts would be discussed and debated in the appropriate policy committees, but if implemented, any such policy changes could have a budgetary impact.

The UI debt is primarily a result of state policy, which specifically mandated business closures during the pandemic. Thus, it makes sense for the state to shoulder the primary burden for repaying this debt. While there is nothing stopping the state from helping pay down this debt other than political will, one potential way to encourage state payments would be to add the UI debt to the list of liabilities eligible for payment under Proposition 2 (2014). This would require voter approval, and the trade-off would be less funding for the existing Proposition 2 obligations. However, after Democrats refused to use the previous surplus to pay for debts their policies incurred, an expansion in Proposition 2 flexibility may help.

Continues Funding to Modernize the EDD. The Governor's budget includes $124 million ($62 million General Fund) for the fourth year of EDDNext, a five-year plan to modernize the EDD. This includes efforts to modernize EDD's benefit systems, improve customer service delivery, simplify forms and notices, develop anti-fraud analysis tools, and speed up application processing. This work is long overdue. The majority party knew over a decade ago that EDD's systems were inadequate for its mission, but Democrats prioritized many other programs in the budget. This neglect set the stage for EDD's horrendous performance and billions in fraudulent claims paid during the pandemic.

Public Safety and Judiciary

Key Points

- **Experiment in Softening Prison Experience Continues.** Governor proposes additional millions to make prison feel less like prison. Long-term public safety impact unknown.
- **Governor Ignores Popular Mandate as Violent Crime Trends in Wrong Direction.** Governor ignores voters' mandate to combat crime, expressed through Proposition 36, as his budget includes no significant new funding to implement the initiative.
- **Modest Additions for Targeted Efforts.** Budget includes modest funds for internet crimes and human trafficking efforts, as well as funds to implement recent Democratic gun control bills.
- **Reversal of Reduction to Court Funding Provides Some Relief, but Not Enough.** Governor partially reverses ill-advised trial court reduction, but specter of civil court delays remains.

Department of Corrections and Rehabilitation (CDCR)

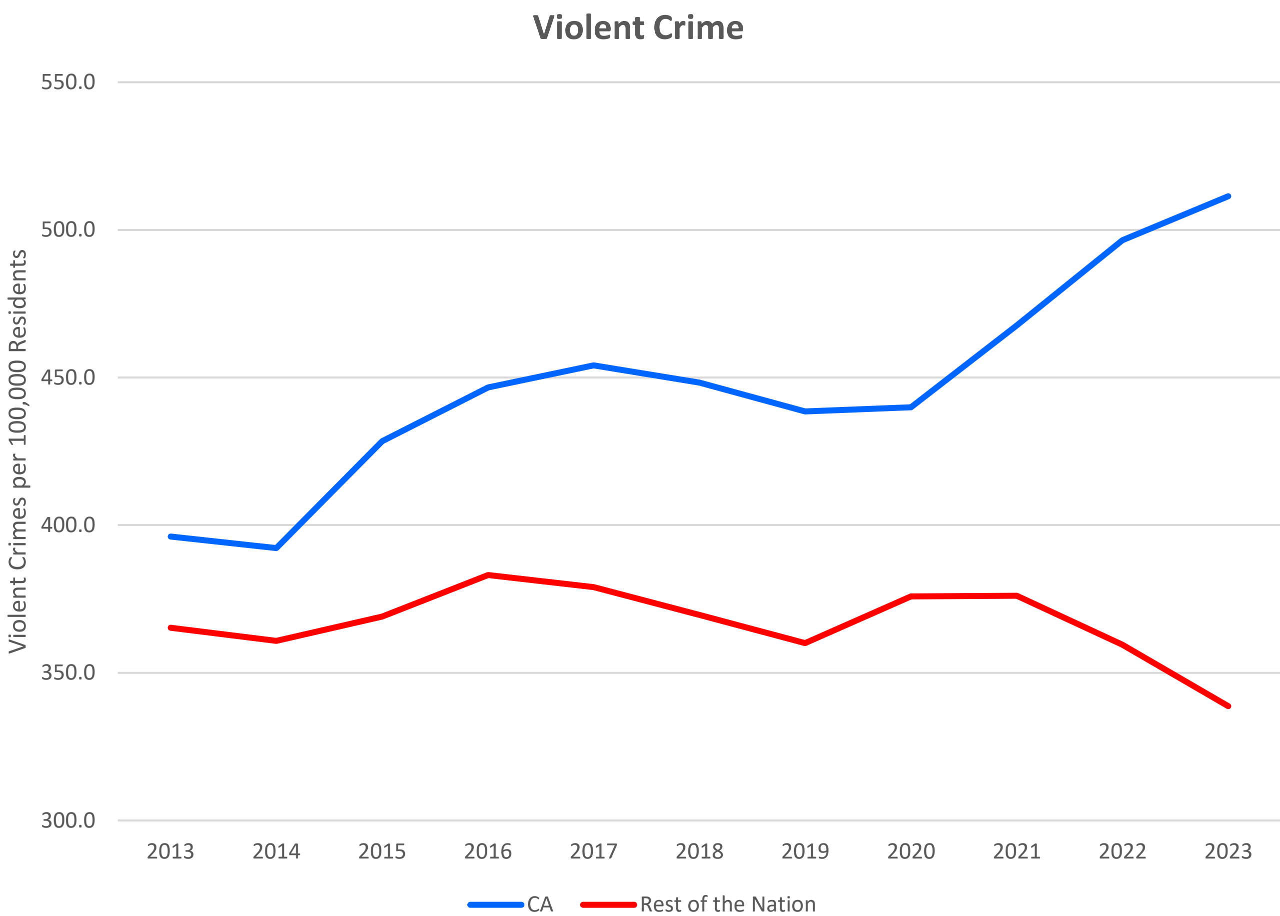
The Governor's budget proposes total funding of $13.9 billion ($13.5 billion General Fund) for CDCR in 2025-26. This is a decrease of $434 million compared to the 2024-25 budget at enactment.

Retirement Rate Contribution. In 2024-25, the state made a one-time pension contribution payment of $1.7 billion to offset the normal General Fund contribution. The Governor claimed this satisfied the debt payment requirements of Proposition 2 (2014). This budget reflects the impact of that payment on CDCR's employer retirement contributions, which amounts to a $691 million General Fund reduction in 2024-25 and 2025-26. While other departments also saw pension contribution offsets, the size of CDCR's workforce and its higher pension tier combine to make this adjustment very large for CDCR.

Governor Softens the Prison Experience. In 2023, the Governor announced one of his many "reimagine" initiatives. This one, dubbed the "California Model", seeks to reimagine the prison system and improve outcomes by making life behind bars more like life on the outside. The prototype for this new model is a project at the San Quentin Rehabilitation Center to create a less harsh physical environment through construction of new facilities and to surround inmates in a warm blanket of programming intended to comfort the criminality out of them. The budget proposes $7.8 million in 2025-26 and $13 million annually thereafter to increase staffing and expand rehabilitative programming to continue implementation of the California Model at San Quentin. It remains to be seen whether making prison more palatable will have a positive or negative impact on public safety in the long term.

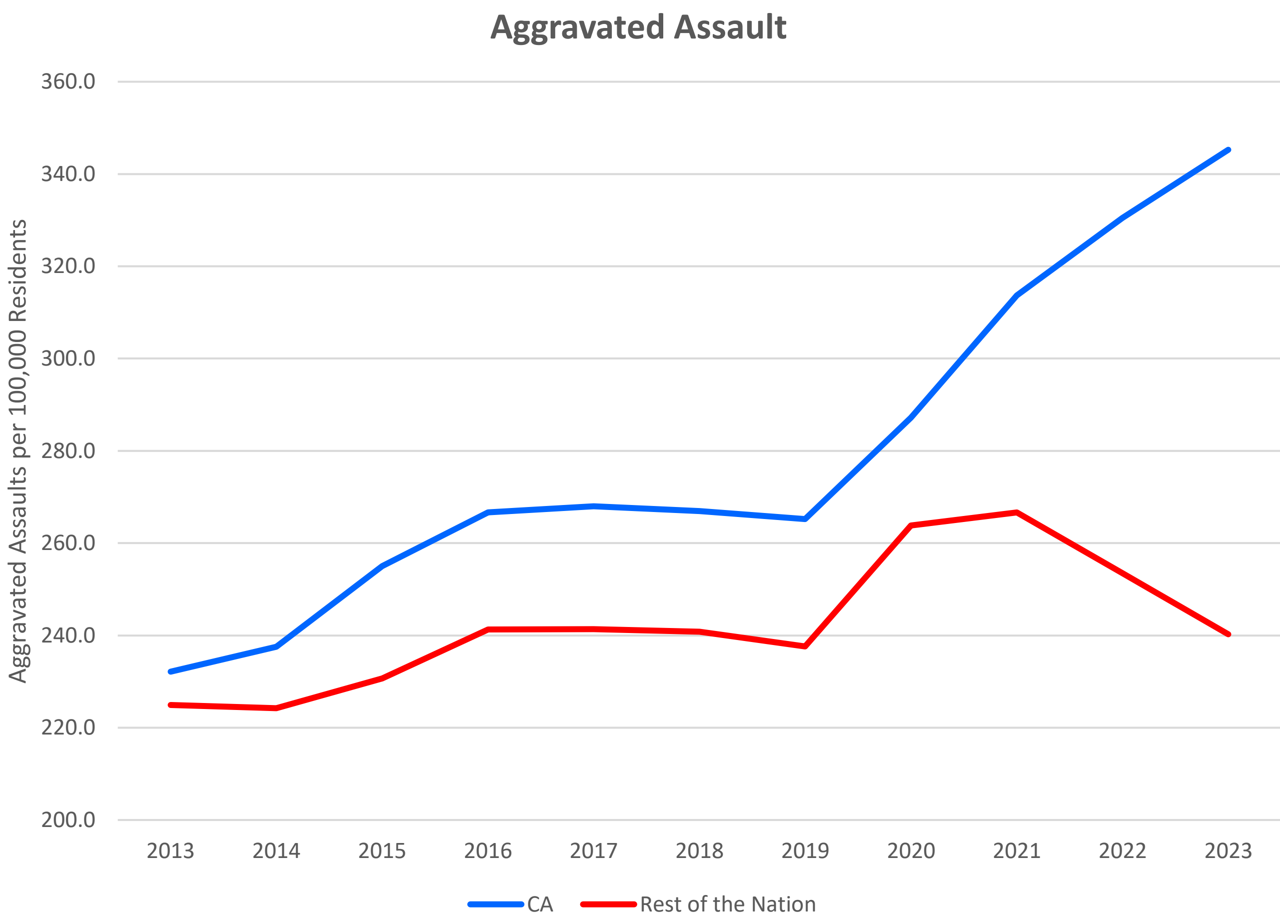
Crime Trends: California Exceeds National Averages

Violent Crime. Violent crime rates in the rest of the nation remained relatively flat over the past decade and actually saw a 10 percent decrease from 2020 to 2023. In California, however, violent crime has continued the upward trend that began in 2015, following the enactment of Proposition 47 (Prop 47) in 2014, as reflected in the chart below. Since Prop 47 took effect, the state's violent crime rate has increased by more than 30 percent. By 2023, the most recent year for which nationwide crime data is available, Californians were 51 percent more likely to be victims of violent crime than non-Californian U.S. residents on average.



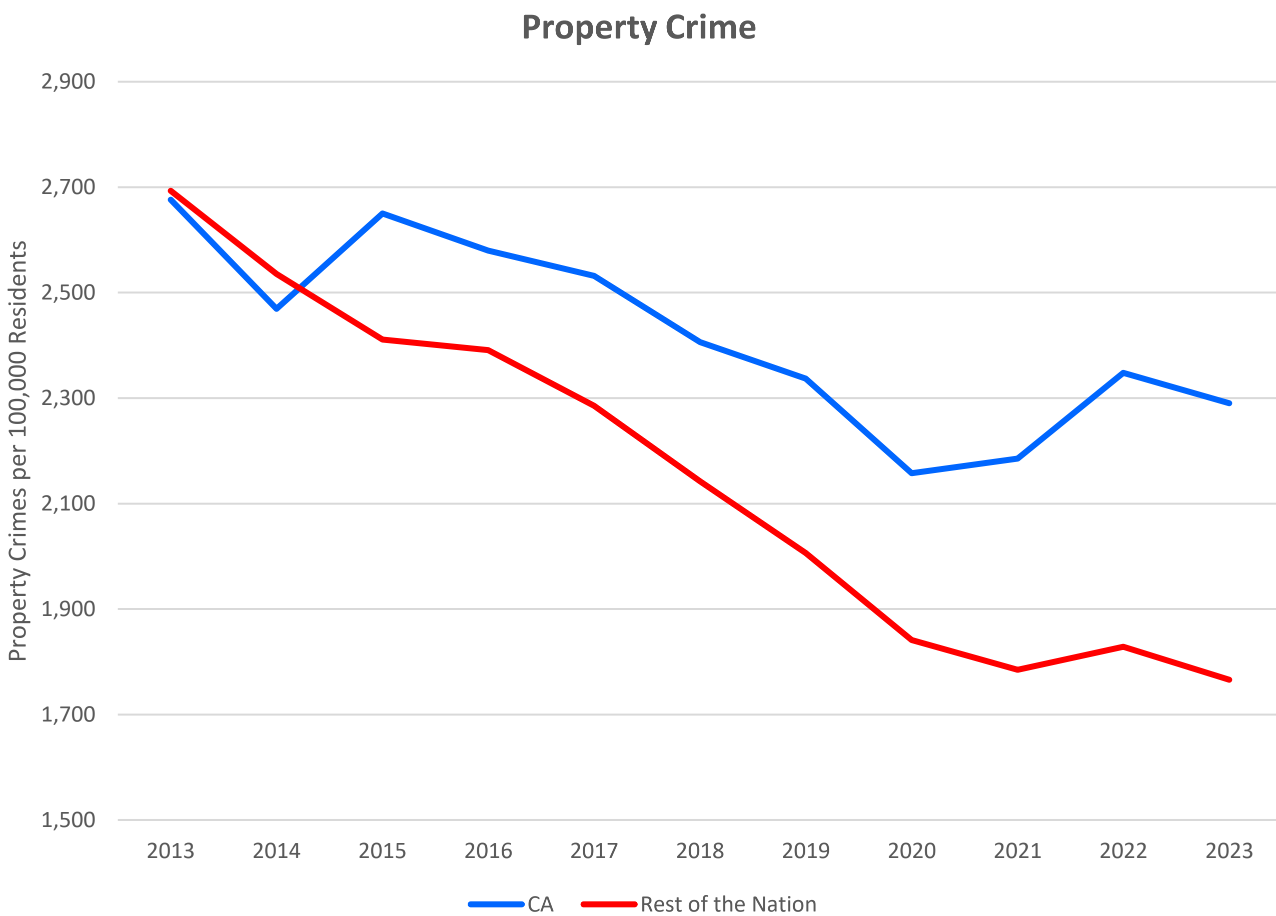
Data Source: Federal Bureau of Investigation's Crime Data Explorer.

Contributing to the overall increase in violent crime is a dramatic increase in aggravated assaults that coincided with the onset of the COVID-19 pandemic. While this started as a nationwide trend, the sudden increase in aggravated assaults dropped off sharply in the rest of the nation in 2022, and by 2023 it had returned to pre-pandemic levels. There was no drop-off in California, however, as reflected in the following chart. Aggravated assaults in this state have increased by an average of seven percent per year since 2019. By 2023, Californians were 44 percent more likely to be victims of aggravated assault than their counterparts.



Data Source: Federal Bureau of Investigation's Crime Data Explorer.

Property Crime. California's property crime rate, which had been lower than that of the rest of the nation since the mid-1990s, saw a sudden shift following Prop 47, which reduced the penalties from many property and drug crimes from felonies to misdemeanors. While property crime generally continued its decades-long decline both before and after Prop 47, a significant increase in 2015 (the first year after Prop 47 took effect) pushed California's property crime rate above the rest of the nation as a whole, where it has remained ever since (see chart below). In 2023, Californians were 30 percent more likely than their counterparts in the other 49 states to be victims of property crime.



Data Source: Federal Bureau of Investigation's Crime Data Explorer.

As of 2023, California's property crime rates exceeded those of the rest of the nation in all four categories tracked by the Federal Bureau of Investigation – burglary, motor vehicle theft, larceny, and arson. Alarmingly, Californians are 51 percent more likely to be burglarized and 77 percent more likely to have a vehicle stolen than the rest of the nation on average.

Governor's Response to Recent Crime Trends

While the Governor continues to claim massive investments in public safety, his 2025-26 budget proposal tells a different story. Despite significant increases in violent crime since he began the early release of tens of thousands of convicted felons from the state's prisons during the pandemic, the Governor proposes very little new funding to combat the trend.

Bare Minimum for Proposition 36 Implementation. California voters enacted Proposition 36 (Prop 36) in November 2024 to address problems created by the false promises of Prop 47 in 2014. Prop 47 was approved with almost 60 percent of the vote. Prop 36 was approved with **more than 68 percent** of votes cast last year, receiving more than twice as many Yes votes as Prop 47 (10.3 million for Prop 36 compared to 4.2 million for Prop 47).

Despite this clear voter mandate, the Governor's budget only includes minimal funding to implement Prop 36. It assumes the state prison population will increase due to Prop 36 by 818 inmates in 2024-25 and 1,606 in 2025-26 relative to the population projected in the 2024-25 enacted budget, and thus includes funding for CDCR to house the additional inmates. However, it does not provide any funding for additional court workload to hear more felony vs. misdemeanor cases, nor does it propose any new funds for cities or counties to provide the court-ordered treatment and services to offenders that are at the heart of Proposition 36. Senate Republicans sent a letter in December 2024 urging the Governor to honor the will of the voters by adequately funding Prop 36.

Internet Crimes Against Children Task Force. The Governor's budget includes $5 million General Fund ongoing to sustain the five regional task forces in San Diego, Los Angeles, San Jose, Sacramento, and Fresno. However, this funding only replaces the existing funding base, which is expiring at the end of 2024-25. It provides no expanded capacity or new capabilities.

Human Trafficking and Child Sexual Abuse Investigations. The Governor's budget proposes $5 million General Fund annually, beginning in 2025-26, for the California Highway Patrol (CHP) to expand its Computer Crimes Investigation Unit. The expansion will allow CHP to increase its recent focus on assisting state agencies and local law enforcement partners in combatting human trafficking and distribution of child sexual abuse material (child pornography) throughout California. Aside from the totally inadequate funding for Prop 36 implementation described above, this is the only truly new funding proposed by the Governor to reduce crime.

Department of Justice (DOJ)

The 2025-26 budget includes total funding of $1.3 billion ($496 million General Fund) for DOJ, which reflects no significant change from the 2024-25 enacted budget.

Concealed Weapon Licensure Increase. In 2022, the U.S. Supreme Court in *New York State Rifle & Pistol Association v. Bruen* made it clear that laws requiring "good cause" or "proper cause" for issuance of Carry Concealed Weapon (CCW) licenses are unconstitutional, and that law enforcement has an affirmative duty to issue CCW licenses to all applicants who are not prohibited. Since that decision, DOJ has seen a 34 percent increase in CCW applications and a 15 percent increase in renewals. The Governor's budget includes a $3.2 million ongoing augmentation ($2.7 million General Fund, $519,000 special funds) and 26 positions to backfill expiring limited-term resources and ensure the staffing necessary for DOJ to address the ongoing background investigation workload.

Funds Recent Legislation Making Legal Gun Ownership More Cumbersome. The Governor's budget proposes $2.4 million ($2.3 million General Fund, $122,000 special funds) to implement various firearm legislation, much of which will make keeping and bearing arms more difficult for law-abiding citizens. Examples include SB 53 (Portantino, 2024), which criminalizes storage of a firearm in one's own home unless it is in an approved gun safe or disabled by an approved device, and AB 3064 (Maienschein, 2024), which creates a process for de-listing previously approved firearm safe-storage devices.

Judicial Branch

The Governor's budget proposes total funding of $5.1 billion ($3.1 billion General Fund) for the Judicial Branch in 2025-26. This includes $4 billion to support the trial courts. Relative to the 2024 Budget Act, Judicial Branch spending would be $80 million higher, with funding for the trial courts approximately $74 million higher.

Partial Reversal of Ill-Advised Trial Court Reduction. The 2024 Budget Act included a $97 million unallocated reduction to trial court operations as part of a blanket 7.95 percent reduction to statewide operations. This unallocated reduction would have required courts to delay cases to meet statutory timelines for criminal caseloads, which ultimately would have led to worsening backlogs of civil cases.

The Governor proposes to reverse $42 million of the $97 million reduction on a one-time basis in 2024-25, with funds to come from reserves in the Trial Court Trust Fund. The administration will revisit the topic in the spring to determine if a permanent General Fund backfill is needed to sustain the restoration on an ongoing basis. While the partial restoration is an improvement, the trial courts still face a $55 million reduction in 2024-25 and ongoing, which unfortunately means civil case delays and backlogs are still likely. Furthermore, tapping the Trial Court Trust Fund reserves in 2024-25 could create cash flow problems for individual trial courts and may undermine their ability to plan appropriately for future expenditures.

Community Assistance, Recovery, and Empowerment (CARE) Court Changes. SB 42 (Umberg, 2024) made changes to the CARE Act to facilitate better implementation of services for those with severe mental illness. The Governor's budget includes a $1 million General Fund augmentation for the trial courts to process and mail notices to CARE Court petitioners and for additional hearing time to handle referrals between courts, consistent with the requirements of SB 42. While these changes will certainly improve the court process, it remains unclear whether counties have adequate resources to provide the services necessary for CARE Courts to succeed.

Court Construction Projects. The Governor's budget includes $39 million General Fund to continue seven courthouse construction projects in San Joaquin, San Luis Obispo, Solano, Butte, Fresno, Plumas, and Los Angeles Counties. All projects except for Butte County are in pre-construction phases. The Butte County project is moving to the working drawings and construction phase. The existing facilities these projects will modify or replace are all considered "immediate and critical need". This means they are deficient in all criteria used to evaluate the priority level of the project, including fire-life-safety, court security, and threat of catastrophic events, as well as others. As such, the projects are critical to ensuring the safety of court users and staff, as well as providing for efficient court operation.

Wildfire and Climate Issues

Key Points

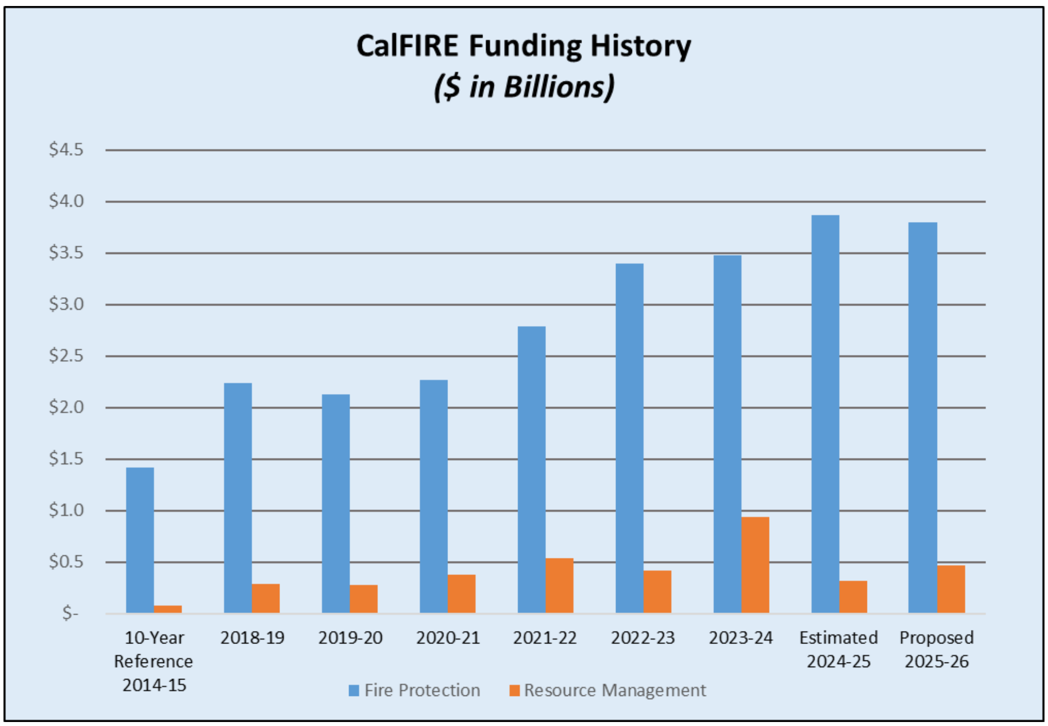
- **Climate Bond Spending Plan.** Lays out a plan to begin spending the $10 billion bond just enacted by voters as Proposition 4.
- **Underfunding for Wildfire Risks.** Despite increased funding in recent years, Democrats have underfunded wildfire preparation efforts compared to the known needs and risks.
- **Wildfire Funding Shift.** Adds $325 million from climate bond to help address wildfire risks, but state cut General Fund in recent years.
- **Lacks Sufficient General Fund Investments.** More investments in forest health and wildfire prevention are needed to combat the ever-growing threat of catastrophic wildfires across the state.
- **Port Upgrades for Offshore Wind Development.** Proposes $228 million for upgrades to California ports to accommodate the development of offshore wind electricity generation.
- **Special Session Wildfire Response Proposed.** Though not part of the January budget, special session bills propose $2.5 billion for response to the Los Angeles wildfires, largely from federal funds.

Begins to Spend New Climate Bond Funds. The Governor's budget proposes $2.7 billion for the first year of a multi-year expenditure plan to implement the $10 billion Climate Bond (Proposition 4) authorized by voters in November. This plan will support accelerating projects and programs that build water and wildfire resilience, help implement nature-based solution climate targets and increase the health of natural systems and their ability to absorb more carbon than they release. Spending on these categories consists of the following:

- *Safe Drinking Water, Drought, Flood, and Water Resilience:* The plan provides $231.5 million for dam safety, $183 million for water quality and safe drinking water projects (including tribal infrastructure), and $173 million for flood control under the State Plan of Flood Control and related initiatives.
- *Wildfire and Forest Resilience:* Wildfire resilience programs receive funding for forest health ($82 million), large-scale forest projects ($79.5 million), wildfire prevention grants ($59 million), and the restoration of 3.8 million acres of state-owned lands ($33 million).
- *Coastal Resilience:* $31 million for coastal resilience, including $20 million for San Francisco Bay projects, $20 million for sea-level rise mitigation, and smaller grants for marine wildlife and dam removal efforts.
- *Biodiversity and Nature-Based Solutions:* Investments include $176 million to enhance fish and wildlife resources, $80 million for nature-based solutions through state conservancies, $9.4 million for tribal nature-based solutions, and $21 million for other biodiversity programs.
- *Extreme Heat and Community Resilience:* Funding supports urban greening projects ($47 million), fairground upgrades ($38 million), the Extreme Heat and Community Resilience Program ($16 million), and smaller heat mitigation initiatives.
- *Sustainable Agriculture:* Sustainable farming programs receive funding for farm-to-school initiatives ($25 million), water efficiency and enhancement ($38 million), healthy soils ($36 million), and invasive species management ($20 million).
- *Outdoor Access:* Outdoor access programs are supported with $190 million for the Statewide Park Program, $84 million for state park system maintenance, $6.8 million for library park passes, and $11 million for improving park accessibility and wildfire mitigation.

➢ *Clean Air and Energy:* Proposes $228 million for port upgrades to support the development of offshore wind and $50 million for the Demand-Side Grid Support Program to incentivize electricity conservation during extreme weather events.

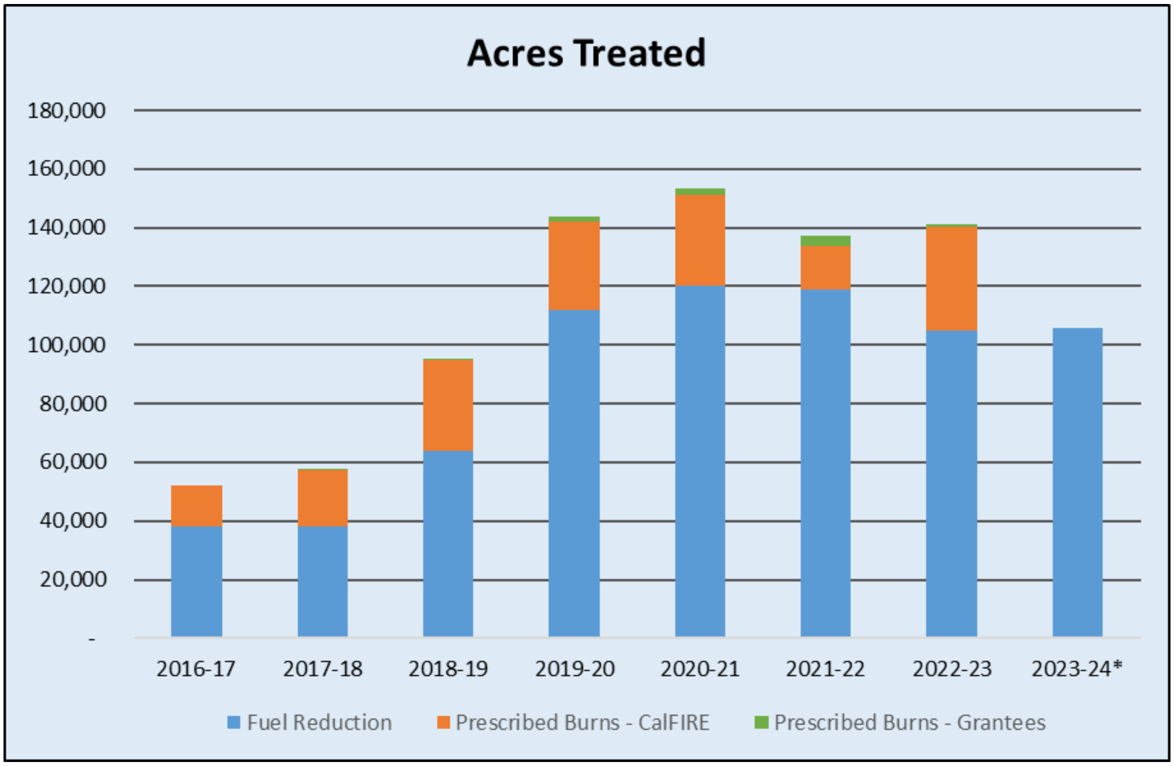
Underfunding for Fire Risks. Catastrophic wildfires, whether in forest or urban settings, result not only in human tragedies but also massive pollution that offsets all California's other efforts to reduce greenhouse gases. California's 2020 wildfire season was estimated to emit twice the greenhouse gas emissions as nearly twenty years' worth of state reductions.[4] Nonetheless, California Democrats only recently began to significantly ramp up wildfire prevention and response efforts. The chart below documents the recent increase in funding for CalFIRE's budget, but considering the major risks to human lives, homes, businesses, and the environment, the state should have been committing billions more to wildfire prevention years ago.



Sources: Legislative Analyst's Office, Senate Republican Fiscal Office

Wildfire Prevention Efforts Lagging. In 2020 California signed an agreement[5] with the federal government to collectively treat one million acres annually by 2025, including 500,000 acres each by the state and federal government. (Note that the federal government owns nearly 58 percent of the state's 33 million acres of forest.) However, CalFIRE reports treating far less than that target level, including controlled burns and treatment, for several years running, as shown in the chart on the next page. CalFIRE has eclipsed the 150,000 mark only once, in 2020-21, and has declined slightly since then. The state needs significantly expanded efforts to begin meeting its obligations under the federal agreement.

[4] LA Times: California wildfires offset greenhouse gas reductions - Los Angeles Times
[5] Governor's Office, 2020 State-Federal MOU



Sources: CalFIRE, Senate Republican Fiscal Office. (Note that data on prescribed burns for 2023-24 is not available from CalFIRE yet but is unlikely to make up the shortfall in targeted treatment acres.)

Recent Budget Cuts for Fire Programs While Other Programs Expand. Despite the notable spending increases beginning in the budget surplus year of 2021-22, Democrats began cutting back funding during the recent budget downturns. The enacted 2023-24 and 2024-25 budgets included cuts to wildfire-related programs of $47 million and $144 million, respectively. (Note that enacted budget levels may not align with actual expenditures each year, depending on the pace of projects.) These budget reductions are minor compared to the overall funding levels, but those levels were already inadequate compared to the clear need.

The California Office of Emergency Services received $122 million in funds for home and community hardening over 2020 to 2022. The state expected to receive matching federal funds of up to $488 million for these efforts. However, following the onset of deficits in 2024, the state budget took back $57 million in unspent state funds, including $45 million for community hardening and $12 million for home hardening, thus losing the potential for $228 million in matching federal funds along the way.

In contrast, the Governor and legislative Democrats chose to continue ramping up spending in other areas of the budget, even during the deficit years. For example, in 2016 Democrats began providing free health care through the Medi-Cal program to undocumented immigrants, and they continued to authorize major eligibility expansions into 2024, despite the budget deficit. California is now on track to spend $24 billion on free health care for undocumented immigrants since 2016, including $8 billion in 2025-26 alone. This amount dwarfs what the state spends on wildfire prevention and suppression, despite wildfire's obvious risks.

Climate Bond Funds Proposed for Fire Efforts. The Governor's budget proposes $325 million from the climate bond for wildfire-related programs in 2025-26. This would be the first year of spending for the total $1.5 billion that the bond authorizes for Wildfire and Forest Resilience. Specific program categories that would receive funds under this proposal are the following:

- ***Forest Health Program:*** $82 million for projects that reduce fuels, reintroduce beneficial wildfire, restore degraded areas, and conserve threatened forests.
- ***Regional Projects:*** $80 million for block grants supporting large-scale, multi-benefit projects led by collaboration with forest health programs in high-risk areas.
- ***Local Fire Prevention Grants:*** $59 million for wildfire prevention projects near vulnerable communities, including fuels reduction, planning, and public education to improve health and safety.
- ***Resilient State-Owned Lands:*** $33 million to enhance the health of 3.8 million acres of state-owned lands by expanding the use of beneficial wildfire.
- ***State Conservancies – Watershed Improvement and Wildfire Resilience:*** $22 million for watershed restoration, biomass utilization, forest health, and workforce development efforts led by conservancies.
- ***Wildfire Mitigation:*** $9.1 million to aid vulnerable populations with structure hardening, defensible space, and vegetation management to reduce wildfire risks.

Fire Prevention Funding Should be a General Fund Priority. Fire prevention funding should be a higher General Fund priority to ensure California can respond effectively and sustainably to the growing threats. While the $325 million from the climate bond for wildfire-related programs are allowable under the bond parameters, bond funds should focus on projects with long-term benefits, while General Fund should be prioritized to supplement prevention and response efforts. Given the escalating risks of wildfires in both urban and forest settings, funding wildfire prevention and forest resilience efforts should be a General Fund priority. Using bond financing for short-term needs is both unnecessary and fiscally inefficient, saddling taxpayers with decades of repayment costs. By prioritizing wildfire funding within the General Fund, California can act with urgency, scale up critical programs, and properly prioritize protecting residents and the environment.

Port Upgrades for Offshore Wind Development. The Governor proposes $228 million from the Proposition 4 for upgrades to California ports to accommodate the development of offshore wind generation. Of the total $10 billion climate bond, $850 million is for clean air and energy projects, with $475 million for port infrastructure.

The bond includes only a small fraction of the $11 billion to $12 billion needed to prepare port sites for development, as estimated by the State Lands Commission AB 525 Port Readiness Plan. Furthermore, this estimate only includes readying the ports for development. It does not include above-grade development, improvements outside the port footprints, or navigational channel improvements.

Moreover, California has a long way to go before a single windmill is in the water. Environmental impacts and mitigation measures have not been fully assessed. Additionally, the viability of floating turbines as large as the Eiffel Tower in the deep waters of the Pacific Ocean is simply not known. Thus, spending taxpayer dollars on port upgrades now may be placing the cart before the horse.

Special Session Bills for Fire Response Proposed. Though not part of the January budget, special session bills propose $2.5 billion for response to the Los Angeles wildfires, largely from federal funds. Democrats introduced SB X1 3 (Wiener) and SB X1 4 (Wiener) to provide a combined $2.5 billion in response to the Los Angeles wildfires, primarily from federal funds.

Transportation

Key Points

- **Gasoline Taxes Increase Again.** The automatic annual gas tax increase will raise the price of gas by 1.1 cents per gallon, effective July 1, 2025.
- **High-Speed Rail.** Proposes $980 million in 2025-25 for continued construction and reflects increased current year spending of $2.3 billion, mostly from carryover funds from the prior year.
- **High-Speed Rail Office of the Inspector General**. Includes $4.3 million for the High-Speed Rail Office of the Inspector General, reflecting an increase of $1.3 million.

Gasoline and Diesel Taxes Rise Again. Despite claims to prioritize affordability for Californians, the Governor proposes no changes to the existing law that automatically raises gasoline and diesel taxes every year. The Department of Finance indicates that on July 1 the tax on gasoline will increase by 1.1 cents per gallon, and the diesel excise tax will increase by 0.8 cents per gallon. These increases and the resulting revenues are reflected in the chart below.

July 1, 2025 Gas and Diesel Fuel Tax Increases

	Current Tax (per gallon)	Increase (per gallon)	New Tax Amount (per gallon)	Increased Tax Revenue (in millions)	Total Tax Revenue (in millions)
Gasoline	$0.596	$0.011	$0.607	$143	$7,883
Diesel	$0.454	$0.008	$0.462	$25	$1,601
Total				$168	$9,484

(Compiled with data from Department of Finance)

California's Gasoline Prices and Taxes Among Nation's Highest. California leads the way in many categories, including the nation's highest gas prices and highest gas taxes. The average price for a gallon of gasoline in California is currently $4.45, second only to Hawaii, and 42 percent higher than the national average. As noted above, California's current gas tax of 59.6 cents per gallon, the highest in the country, is set to increase on July 1st. In addition to these taxes there are various environmental fees built in to the price of gasoline, including costs related to the state's Cap and Trade and Low Carbon Fuel Standards programs, as well as the increased cost of producing the state's special summer blend. In fact, gasoline prices could increase yet again by 65 cents per gallon[6] this year thanks to revisions to the Low Carbon Fuel Standards program by the California Air Resources Board.

New Regulation Could Drive Prices Higher. Less than a year and a half after implementing legislation to prevent unsubstantiated "price gouging" by authorizing the California Energy Commission to penalize refiners, the Governor convened another Special Session of the Legislature in 2024, allegedly to prevent gas price spikes. AB x2-1 (Hart 2024) was passed by legislative Democrats and signed by the Governor authorizing the Commission to require certain gasoline supply reserves, subject to penalties. However, neither of these bills address California policies that have driven refineries out of business, resulting in reduced refining capacity. Rather, these regulations are likely to increase refinery costs, and as a result, increase gasoline prices.

[6] Cullenward, David. Kleinman Center for Energy Policy. (2024). California's Low Carbon Fuel Standard. Retrieved from: https://kleinmanenergy.upenn.edu/research/publications/californias-low-carbon-fuel-standard/

California High-Speed Rail

High-Speed Rail Authority. The proposed budget includes $980 million for the Authority to continue construction of a high-speed train, nearly all of which is from Cap and Trade funds. Past and current year budgets are updated to reflect spending of $3.5 billion and $4.3 billion, respectively. The expenditure increase in the current year is the result of carrying over unspent Cap and Trade funds from the prior year. Expenditures are summarized in the chart below.

High-Speed Rail Expenditures (Dollars in Millions)			
Fund Type	**2023-24**	**2024-25**	**2025-26**
Federal Funds	$3,296	-	-
Cap and Trade Funds	$165	$4,305	$936
Bond Funds (Proposition 1A)	$28	$35	$39
High-Speed Rail Property Fund	$2	$9	$2
Reimbursements	-	-	$3
Total	$3,491	$4,349	$980

(Compiled with data from Department of Finance)

The 2024 Business Plan indicated the total cost of completing the train system is up to $128 billion, with no estimated completion date, though much of the data remains based on operations from San Francisco to Los Angeles beginning in 2033, which is improbable. More realistically, operations between Merced and Bakersfield may commence within this time period. The next update report, generally published in the spring of odd numbered years, may provide revised cost and project timeline estimates.

In December 2023, the federal government announced an award of $3.1 billion to the High-Speed Rail Authority. Despite these additional funds, California remains more than $100 billion short of the total needed to build a San Francisco-to-Los Angeles train. The authority has grant applications totaling $217 million currently pending with the federal government, but with a new incoming President, future federal funding awards seem unlikely. In fact, the High-Speed Rail Office of the Inspector General issued a report[7] last year noting the Authority's overly optimistic assessments of potential federal funding awards and lack of communication regarding the urgency of the project's funding situation for the Merced to Bakersfield line. Moreover, the project has yet to receive any private investment.

Despite this outlook and years of valid criticism, Democrats have yet to offer any plausible plan for how to obtain funds to complete the project. Instead, they continue to throw good money after bad in their high-speed rail fantasyland, and call on California taxpayers to foot the bill.

High-Speed Rail Office of the Inspector General. The Governor's budget includes $4.3 million (Public Transportation Account) and 16 positions for the operation of the High-Speed Rail Office of the Inspector General (OIG) to oversee the project. This is an increase of $1.3 million and one new position compared to the 2024 Budget Act. The office, established by SB 198 (Committee on Budget and Fiscal Review, 2022), has broad authority to initiate audits and reviews, conduct independent fiscal analysis, identify best practices, recommend efficiencies, and evaluate contracts. As noted above, the office is producing useful reports that appear to be independent and may encourage the High-Speed Rail Authority to provide more relevant information to the Legislature.

[7] Office of the Inspector General, California High-Speed Rail. (2024). https://hsr.ca.gov/office-of-the-inspector-general/inspector-general-reports/

General and Local Government

Key Points

- **College Corps Volunteer Program.** Commits $83 million ongoing General Fund for one of the Governor's newest ventures, volunteer programs.
- **Cal Competes Grant Program.** Includes $61 million for the unproven California Competes grant program.
- **Continues Tens of Millions of Dollars for Outreach Activities.** Provides $57 million for awareness campaigns associated with public education efforts such as COVID-19 vaccination, water conservation, and extreme heat.
- **National Semiconductor Technology Center.** Proposes $25 million General Fund to reimburse a non-profit for capital expenditures to build a new technology center.
- **Regional Initiative for Social Enterprises Program.** Includes $17 million General Fund for the Regional Initiative for Social Enterprises program, an effort to remove job barriers.
- **Governor Proposes a "Belonging" Campaign.** Includes $5 million in one-time General Fund to launch what the Governor is calling a "Belonging Campaign" by January 2026.

California College Corps Volunteer Program Prioritized. The Governor's budget would provide $68 million General Fund in 2025-26 ($63 million in base funding, as well as an additional $5 million General Fund proposed in the budget year), and $83 million General Fund ongoing for the California College Corps. The California College Corps, a volunteer program established in 2021-22 with $145 million General Fund, is a partnership with the University of California, California State University, California Community Colleges, and private California university systems to support lower debt college pathways for low-income students, service opportunities, and career development.

The program resides within the recently established Governor's Office of Service and Community Engagement, and the Governor proposes to make the program a permanent part of the CalVolunteers portfolio. Although incentivizing increased volunteer participation and relieving some of our students' high secondary education costs may be meritorious, given the ongoing financial constraints facing the state, committing General Fund for a volunteer program is not a fiscally sound or appropriate prioritization of the state's limited resources. Ironically, the Governor's budget continues previously planned cuts for the universities themselves, while this program would receive an increase.

CalCompetes Grant Program. The budget provides $61 million in one-time General Fund for the CalCompetes Grant program in 2025-26. The CalCompetes Grant program is a relatively recent program expansion intended to support businesses that are unable to participate in the CalCompetes Tax Credit program.

The program provides financial subsidies to businesses that agree to stay in, or relocate to, California in exchange for investment and job creation commitments. In addition to $180 million in annual tax credit allocations to the CalCompetes Tax Credit program, the 2021-22, 2022-23, and 2023-24 budgets allocated $120 million General Fund each year for CalCompetes grants, with priority given to the semiconductor industry in recent allocations. To help address the budget shortfall, the 2024-25 budget did not include funding for the program. Given the fiscal constraints continuing to face the state, and the so-far unproven merits of the program, it is not clear that this proposal is the best use of new General Fund.

Budget Continues Millions for Outreach Support. The budget proposes $57 million General Fund in 2025-26 within the Governor's Office of Community Partnerships and Strategic Communications for community engagement and awareness campaigns associated with public education efforts such as COVID-19 vaccination, water conservation, and extreme heat. Given the state's uncertain revenue future and the continued over-spending by the majority Democrats, prioritizing General Fund resources for outreach campaigns should be reconsidered. These funds may be put to better use providing support for local governments' homelessness efforts and activities tied to the recently approved Proposition 36.

National Semiconductor Technology Center. The budget proposes $25 million General Fund to reimburse Natcast for capital expenditures to build a new semiconductor technology center. In November 2024, the U.S. Department of Commerce and Natcast, the non-profit entity designated by the Department of Commerce to operate the National Semiconductor Technology Center, announced Sunnyvale as the location for the Creating Helpful Incentives to Produce Semiconductors for America Design and Collaboration Facility. The Governor's budget includes one-time General Fund to reimburse Natcast for capital expenditures to build the facility. Although the addition of the center could provide job growth and economic activity to the region, it is unclear what criteria was used to determine the selection of this one facility for state General Fund support over other projects that may also be worthy and struggling to pull together sufficient capital for projects.

Regional Initiative for Social Enterprises Program. The budget includes $17 million one-time General Fund for the Regional Initiative for Social Enterprises program within the Governor's Office of Business and Economic Development. The program, established in 2022-23 with $25 million in one-time General Fund, provides financial and technical assistance to employment social enterprises. These organizations in turn provide jobs, on-the-job training, and specialized support to people who face high barriers to work, including homelessness, previous incarceration, substance use, or mental health issues. The Administration indicates nearly all of the initial program funding has been either spent ($20 million) or is promised to be spent within the next year ($5 million), but the department has yet to provide program outcomes or performance data that could determine either the success or the failure of the program.

Governor's "Belonging Campaign." The Governor's budget includes $5 million in one-time General Fund to launch a Belonging Campaign by January 2026. The Administration will initiate research projects to evaluate how connected Californians feel to their communities, develop a strategy to improve the state's efforts in engaging community, and encourage increased applications for the state's service corps. This effort apparently is intended to help communities better identify pathways to social connectedness and engagement. The inclusion of state funding for what sounds like a "feel good" campaign is baffling and tone-deaf given the critical policy issues facing the state. It is unclear how providing $5 million for a research project to determine Californian's definition of "belonging" will benefit Californians who face an ever-growing affordability crisis due to the state's cost-raising policies.

Museum Of Tolerance. The Governor's budget includes $10 million one-time General Fund for capital improvements supporting the Museum of Tolerance, which provides diversity training to California teachers and criminal justice professionals. Without debating the merits of the museum, it is unclear why this project has been provided General Fund in the budget as opposed to other capital improvement projects supported by communities across the state.

State Employee Compensation and Retirement

Key Points

- **Savings Erode from Vacant Position Sweep and Operations Reduction.** Savings from last year's actions are now projected to be lower by $1.5 billion than budgeted, validating concerns raised about achievability.
- **Contributions for State Retirement.** Proposes $9.1 billion in state contributions for state pension costs, a decrease of $2.3 billion compared to last year, but an overall increase of $4.1 billion compared to a decade ago.
- **Upcoming Pay Increases for State Employee Unions Unknown.** Includes a set-aside for employee compensation for seven bargaining units. Includes an unknown dollar amount for the completed bargaining unit contracts.
- **Proposition 2 Debt Repayment.** Proposes $1.5 billion in one-time Proposition 2 debt repayment funding for 2025-26 to reducing the unfunded pension liabilities, the minimum required under law.

State Employee Growth Outpaces Population Dramatically. Over the past decade, the state population has grown by only 1 percent, to about 39 million people, and has been flat over the past seven years. Over the same period, the number of state employees has grown nearly 24 percent, to a projected 436,435 in 2025-26, including a jump of 14 percent, or about 54,000 employees, since the pandemic started. The number of state employees per 1,000 residents will be over 11 in 2025-26, the highest level in state history. This is particularly notable considering that the state "realigned" significant prison and human services responsibilities to counties over a decade ago, which should have decreased the number of state employees per resident.

Employee Compensation and Collective Bargaining Costs. The state will negotiate this year with seven bargaining units, including Attorneys, Correctional Officers, Professional Engineers, Physicians, Dentists, Psychiatric Technicians, and Health and Social Services Professionals, whose contracts expire in summer 2025. The budget includes a set-aside for employee compensation for these bargaining units; however, since the set-aside is subject to negotiations in the bargaining process, the Governor's administration chooses to keep the amount confidential.

Savings Erode from Vacant Position Sweep and Operations Reduction. The 2024 Budget Act authorized a sweep of 10,000 vacant state positions and an unallocated reduction of 7.95 percent in statewide operations. The Governor's budget now reflects lower-than-budgeted savings from these actions. The vacant position sweep would reach only 6,500 positions and a permanent reduction of $618 million ($234 million General Fund) rather than the previously assumed savings of $763 million General Fund. The 7.95 percent operations reductions would achieve savings of $1.2 billion in 2025-26 and thereafter, compared to last year's assumed savings of $2.7 billion.

The Governor's administration indicated that it identified some previously estimated positions and state operations expenditures as critical to public safety, 24-hour staffing requirements, and delivery of mission-critical public benefits. These positions were removed from the savings targets. It remains to be seen whether the revised savings estimates are in fact achievable.

Given the growth in state staff, as described above, and future deficits, Senate Republicans found these savings actions to be warranted when proposed last year, but raised concerns that the Governor would not actually achieve the savings in practice. Those concerns are shown to be valid in the Governor's eroded savings estimates.

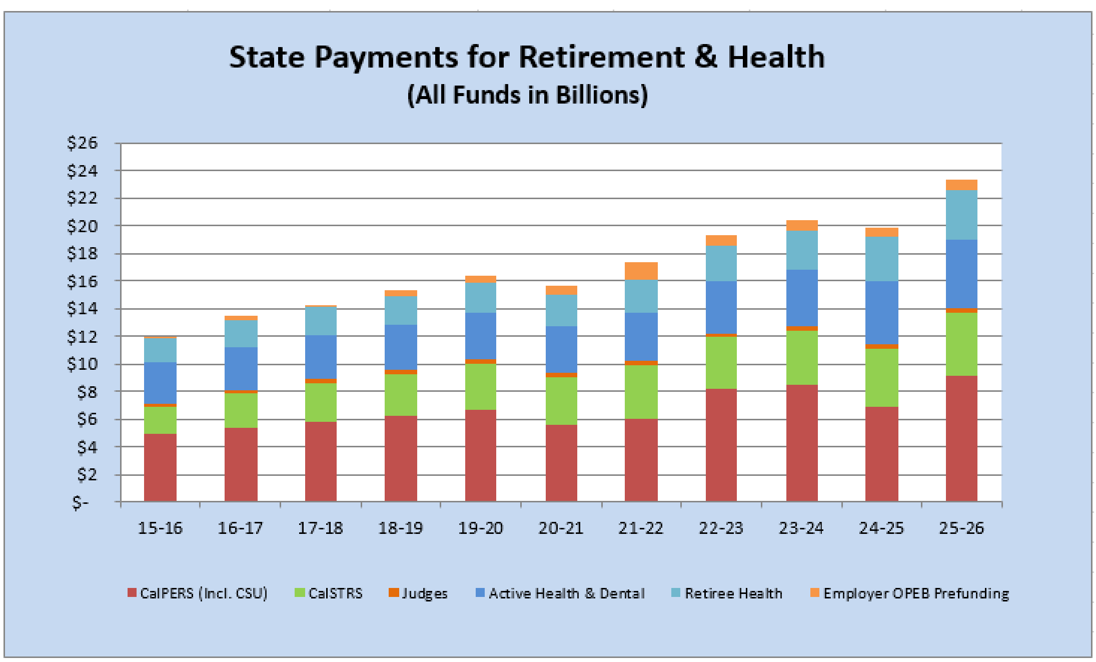
Proposition 2 Funding. The Governor's budget proposes to include $1.5 billion in one-time Proposition 2 supplemental pension payment to further reduce the state plans' unfunded pension liability, $1.2 billion more than the 2024-25 budget allocation. The budget also includes $385 million one-time Proposition 2 debt repayment funding in 2025-26 for the employer's share of contributions to pay for future retiree health benefits.

CalPERS Pension Costs Continue to Grow. The Governor's budget authorizes $9.1 billion in total funds ($4.9 billion General Fund) in employer contributions to Public Employee Retirement System (PERS) for state employees' retirement costs, an increase of $2.3 billion ($1.5 billion General Fund) compared to the 2024 Budget Act. The apparent increase is likely due to a one-time funds shift from Proposition 2 debt repayments that artificially lowered the 2024-25 amount. The total contributions are up $4.1 billion compared to ten years ago, an increase of 85 percent.

Teacher Pension Costs Also Grow. The Governor's budget includes $4.6 billion General Fund for state contributions to CalSTRS, the teachers' pension fund. This is roughly a $367 million increase from 2024-25, which is due to higher-than-anticipated growth in creditable compensation from 2022-23 to 2023-24.

Retiree Health Care Benefits. The Governor's budget proposes to include $3.6 billion ongoing for health care benefits for state retirees, California State University retirees, and dependents. Retiree health care benefits continue to be paid out mainly on a "pay-as-you-go" approach, which has created a $92 billion unfunded liability.

Total State Cost for Retirement and Benefits. To highlight the costs over time of various benefit actions, the graph on the next page illustrates combined budgetary costs for employer contributions to PERS and STRS, along with costs for retiree health, active health, and other retirement prefunding over the past decade. State pension, retiree health, and other benefit costs combined will increase to just over $23 billion in 2025-26, nearly doubling over the past decade. During that same period the state's overall budget grew by slightly more than double as well, following the dramatic increase in General Fund spending in the past three years.



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